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NOMINATIONS OF MANUEL H. JOHNSON, JR. AND WILLIAM F. RYAN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

THE NOMINATIONS OF

MANUEL H. JOHNSON, JR., TO BE VICE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR A TERM OF 4 YEARS

AND

WILLIAM F. RYAN, OF NEW JERSEY, TO BE FIRST VICE PRESIDENT OF THE EXPORT-IMPORT BANK OF THE UNITED STATES FOR THE REMAINDER OF THE TERM EXPIRING JANUARY 20, 1989

JUNE 12, 1986

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NOMINATIONS OF MANUEL H. JOHNSON, JR., TO BE VICE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND WILLIAM F. RYAN, TO BE FIRST VICE PRESIDENT OF THE EXPORT-IMPORT BANK

THURSDAY, JUNE 12, 1986

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 9 a.m., in room SD-538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, D'Amato, Gorton, Mattingly, Hecht, Proxmire, and Dixon.

OPENING STATEMENT OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

This morning I wish to welcome Dr. Johnson back before the Banking Committee, the second confirmation hearing in this calendar year. On January 23, Dr. Johnson appeared before the committee as a nominee to be a member of the Board of Governors of the Federal Reserve System. Today he comes before us as a nominee to be Vice Chairman of the Board.

In recognition of the importance of the position as Chairman and Vice Chairman of the Board of Governors, Congress in 1977 passed legislation requiring Senate confirmation of the President's designation of a Board member to serve a 4-year term as Chairman, as well as Senate confirmation of the President's designation of a Board member to serve a 4-year term as Vice Chairman.

Dr. Johnson, you are the third nominee for Vice Chairman to come before the Senate for confirmation for that position. Your two predecessors came before the Senate as nominees to the Board and the Vice Chairmanship at the same time.

You have the distinction of being the first person to come before the Senate for the sole purpose of confirmation as Vice Chairman of the Board of Governors.

This is a position of critical importance in our Government. I believe it is certainly appropriate for it to be the subject of Senate confirmation.

You'll have a very important role in the formation of monetary policy. You'll certainly have a major impact on the health of our

financial system. And you will preside over the meetings of the Board of Governors in the absence of the Chairman.

So our purpose this morning is to see and examine how you would handle these responsibilities. We're happy to have you before the committee once again.

Senator Proxmire.

Senator PROXMIRE. I have no opening statement, Mr. Chairman.

The CHAIRMAN. Senator Mattingly.

OPENING STATEMENT FOR SENATOR MATTINGLY

Senator MATTINGLY. Mr. Chairman, I'd also like to welcome Dr. Johnson to the Banking Committee. I thought Dr. Johnson's nomination to serve on Federal Reserve Board was an excellent choice by the President; however, his recent nomination to be Vice Chairman is equally deserving and has my full support.

I recently read where Federal Reserve Board Governor Wayne Angell said he generally favors releasing the minutes of Fed policy-making meetings "at 8:30 a.m. the next morning" after each meeting. I commend Mr. Angell on his remarks and hope Dr. Johnson will also support and speak out on the need for the timely release of the FOMC minutes. I believe that delaying the release of the minutes increases, rather than decreases, uncertainty and volatility in the financial markets. I will soon be introducing legislation to mandate fast release of the minutes and would welcome Dr. Johnson's support and counsel on the issue.

Dr. JOHNSON. Thank you very much.

The CHAIRMAN. Dr. Johnson, do you have an opening statement you wish to make?

Dr. JOHNSON. Mr. Chairman, I don't have a statement to submit for the record, but I do have a few short remarks I would like to make before I deal with questions.

The CHAIRMAN. Dr. Johnson, before you do that, I would like to insert a statement by Senator Warner, and then have you stand and be sworn.

[Statement of Senator Warner follows:]

STATEMENT OF SENATOR JOHN WARNER

Mr. Chairman, it was only 4 months ago that I came before this committee to present Mr. Manuel Johnson to the committee for hearings on the confirmation of his nomination by President Reagan to become a member of the Board of Governors of the Federal Reserve System.

It is now my distinct pleasure to return to this committee to again present Mr. Johnson, this time for hearings on his nomination to become Vice Chairman of the Board of Governors of the Federal Reserve System.

Mr. Johnson's background is as distinguished as it is varied. Before his appointment to the Board of Governors, Mr. Johnson was Assistant Secretary for Economic Policy at the U.S. Treasury Department.

He had been at Treasury since 1981, and prior thereto he was a professor of economics at George Mason University, one of Virginia's most distinguished educational institutions.

He went on to achieve a degree with honors. Among those honors, Mr. Johnson was Omicron Delta Epsilon, Economics Honor Society; Doctoral Dissertation, Nuclear Regulatory Commission. He received various awards, among them; Labor Economics Prize, best research paper in labor economics; honorary president, Troy State University; Alumnus of the Year in 1982, Troy State University; Honor Award for Outstanding Contributions to Public Policy, Florida State University; Secretary's Honor Award for contribution to first foreign-targeted securities issue, U.S. Treasury Department. And on goes this most distinguished biography.

I'm privileged to be here today to recommend to this committee this outstanding American public servant.

I thank the chairman and members of the committee.

[The nominee is sworn.]

Senator GARN. Please proceed.

STATEMENT OF NOMINEE DR. MANUEL H. JOHNSON, JR.

Dr. JOHNSON. Thank you, Mr. Chairman, and members of the committee.

Once again, it's an honor to appear before this distinguished committee for your consideration of my appointment as Vice Chairman of the Federal Reserve Board. If confirmed, I'll make every effort to encourage monetary policies that are consistent with sustained economic growth, employment, and price stability.

Also, I hope to work with members of this committee to rationalize Federal banking regulation and supervision in a way that will improve the safety and soundness of the financial system, while serving the growing demand for financial services.

These are challenging times for economic and financial policy and I appreciate the opportunity to serve the public in such a responsible position.

That's all I wanted to say as an introduction. Thank you.

The CHAIRMAN. Dr. Johnson, do you agree to appear before this committee or any other duly constituted committee of Congress when requested to do so?

Dr. JOHNSON. Yes.

M1 GROWTH RATE EXCEEDS TARGET RANGES

The CHAIRMAN. Since late 1984, the M1 monetary aggregate has been growing at rates well in excess of the Fed's target growth ranges. This would certainly indicate a strong monetary stimulus to the economy.

Do you believe these growth rates in M1 have given a misleading indication of the amount of monetary stimulus to the economy?

Dr. JOHNSON. Well, I think that they shouldn't be ignored, by any means. They certainly are a factor that I think we have to weigh heavily. But, at the same time, there are some special circumstances associated with the rapid growth in M1 especially that I think make it important that we look to other characteristics of the economy, in addition to just the monetary aggregates to make some determination for monetary policy.

One of the factors that seems to be driving the sharp growth in M1 recently has been the considerable decline in interest rates over the last several months. They've stabilized fairly recently, but they have come down quite a bit, both in short- and long-term rates. And inflationary expectations appear to have come down also as a result of the decline in oil prices and progress that was made with Gramm-Rudman-Hollings.

Now, one of the reasons why this has affected M1 has been the fact that we now pay interest on transactions accounts like NOW accounts and super NOW accounts, which are part of M1. And as interest rates have fallen, the interest difference between what you can earn on a checking account such as a super NOW and what

you would earn on a bank certificate of deposit has narrowed so substantially that individuals and corporations or businesses are shifting large amounts of their funds into M1-type accounts, super NOW accounts and other checkable deposits that bear interest.

So what you're seeing is a situation where long-term certificates of deposit are maturing and not being renewed over the long term because interest rates are so low and are not that much different from short-term rates on super NOW accounts. And so people are basically just saying,

Why should I lock my money up for several years at this low rate? Why don't I just keep it liquid? The interest differential is practically negligible and I can house my savings in an M1-type account.

And so we're seeing a good deal of growth in M1 as a result of these kinds of behavior.

So, to some extent, a large portion of M1 is now a savings component. But, of course, it's sensitive to interest rates and inflationary expectations. And, as long as interest rates remain low and inflationary expectations stay down, I don't think it's a problem. But we have to be sensitive to the fact that this could turn around at some point and cause the so-to-speak velocity of M1 to pick up sharply as people decided to start spending this money that's being used more in the form of savings.

This is one reason why we can't rely too heavily on M1, itself, and we have to look at other factors, like what is happening to bond yields, what is happening to the relative exchange rate, and at the same time, what is happening to other indicators in the economy, like the leading indicators and commodity prices and things of this nature.

M1 GROWTH RATE COULD REIGNITE INFLATION

The CHAIRMAN. Well, I understand it's far more complex than a lot of people would like to believe it is. We read every day about the close correlation between M1 and inflation, but it's much more complex than that.

Still, when we have gone such a long period of time being over the targets, do you feel if this continues, we are going to reignite inflation, or at least the danger of new inflation?

Dr. JOHNSON. Well, it certainly can't go on indefinitely. I think that permanently excessive amounts of money growth do show up in inflation. I don't think there's any doubt about that.

So I think that we have to be very careful about allowing M1 to grow at a sustained rate above target. But at the same time, we do have to, I think, question whether our targets themselves are adequate given some of the changes in behavior that have resulted.

I think that we should continue to monitor the monetary aggregates very carefully. Of course, if M1 were to continue to show a lot of strength at the same time that the economy was starting to show strength and we were seeing long-term bond rates start to rise and the exchange rate come under pressure, I think that we would have to be substantially more sensitive to M1 than we have been currently.

The CHAIRMAN. Do you believe that we should reconsider our definition of money or how we measure velocity?

Dr. JOHNSON. Well, I think that if we're going to continue to use the current measure of M1 as a way of monitoring the economy, we are, I think, going to have to accept the fact that the velocity of money is not behaving in a way characteristic of its historical trend and we're going to have to make those adjustments. I think that might have to show up in the way that we set the target for M1 in the future.

But I know that some analysts have proposed going back to the old measure of M1, taking out the interest-bearing components of transactions accounts somehow and separating those out and just simply looking at demand deposits and currency. Of course, that's one way to do it and that's a much more stable relationship over time.

But the problem is that these interest-bearing accounts are used both for savings and transactions and because of that, you really can't separate them out completely because you would be taking out a potential source of transactions.

So I think that we're probably forced to deal with looking at interest-bearing transactions accounts as part of M1. But we just have to understand that there is a large degree of savings going on in what was formerly a purely transactions account. We do the best we can to interpret changes in behavior that might affect that part of the M1 component.

But it is useful to look at other measures I think that are more stable, like the monetary base and bank reserves.

SPECULATION OF DISCOUNT RATE CUTS

The CHAIRMAN. Let me put you on the spot. There's been a lot of speculation in the last few days about a further cut in the discount rate and whether Germany is going to cut their's first.

Do you anticipate a further cut in the discount rate soon?

Dr. JOHNSON. Well, I think what we do with the discount rate is really going to be dependent on the domestic economic situation, pretty much on how our economy develops over the next weeks and months and whether the depreciation in the dollar we've seen since the peak levels of last year start to show up in some inflationary pressures or not, whether some of the financial indicators which have been showing strong expansion actually show up in the real economy.

I think right now, we have a relatively sluggish situation in the second quarter, mainly because of a buildup in automobile inventories and the cutbacks in the oil-producing sector of the economy.

But I think we have to look beyond that, these temporary phenomena going on with the oil industry and the automobile inventory situation, and determine whether the second half of the year is going to show stronger expansion.

Of course, if it doesn't, I think we would have to readdress the discount rate issue and, of course, a lot would depend on what our major trading partners do.

We have major trading partners who are in substantial surplus trade positions and have benefited more from the oil price decline than the United States because they have no domestic production,

they have higher unemployment rates in Europe, and they have more room for expansion.

We have the large trade deficit and the weaker currency at this time. They have the strong currencies.

And so, I think that we would expect both the German and Japanese economies to pursue more stimulative policies given the environment that I have described. I think we would like to see them take more of the lead, since they are the large surplus nations and we have the large deficit.

So I think we'd have to be cautious about considering the discount rate in the future and a lot would depend on what Japan and Germany did with their own discount rates and at the same time, what economic developments look like in the United States.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

Governor, there's been a lot of discussion regarding the board's decision last February to lower the discount rate over Chairman Volcker's objection. As I understand the issue, it was not whether the rate should have been reduced, on which there was general agreement, but, rather, whether the Federal Reserve should have taken the lead in advance of the central banks of Germany and Japan.

Why did the four Governors feel that this was an important enough issue to outvote the Chairman? Isn't this the kind of timing issue on which the views of the Chairman have been and should be given special weight?

Dr. JOHNSON. I think that's right. I think the Chairman certainly has tremendous experience in the international area and I think that his views carried considerable weight in the discussions.

There's no doubt about that.

REASONS FOR FED CUT IN DISCOUNT RATE

As you said, there really was no opposition by anyone on the Board at the time over whether to cut the discount rate or not. It was a matter of timing.

I think that some of the other Board members felt that Germany and Japan might decide to hold off on an indefinite basis on their decisions to pursue a lower discount rate without some pressure on their exchange rates from domestic action in the United States.

I think that it was a reasonable view that our major trading partners did not feel pressure to act and were not anticipating any immediate move on the discount rate, and over some frustration with that, I think the feeling was that maybe if the United States led the way and made their currency somewhat vulnerable, they might feel more compelled to pursue a coordinated rate reduction.

And so, I think that was the flavor of the debate over whether or not to cut the discount rate at that time.

However, that those feelings weren't so strongly held that compromise was impossible. Once the Board made contact with the German and Japanese central banks to discuss a coordinated effort, there was agreement by the majority of the Board to postpone the action.

I think that the outcome showed a desire for consensus on the Board, rather than confrontation.

So I think what's unfortunate is that the 4 to 3 decision, which really never became effective, was made public, because ultimately, everyone got what they wanted and the final vote on the discount rate 1 week later or so was 6 to 0.

Senator PROXMIRE. Some Fed watchers in the financial press have said that Preston Martin saw his role as the Vice Chairman as the leader of President Reagan's appointees to the Board.

How do you view your role as Vice Chairman, and do you foresee any differences in the way that former Vice Chairman Martin carried out his duties?

Dr. JOHNSON. Well, I certainly can't speak for Vice Chairman Martin on how he saw the Vice Chairmanship. But I can tell you what I think the role is, from my own opinion.

I think the role is exactly what's indicated in the statutes, and that is that the Vice Chairman serves as the chief spokesman for the Board and has parliamentary functions in the absence of the Chairman.

And so, the role of the Vice Chairman, I think, is to represent the consensus views of the Board of Governors and to back up the Chairman. It's not a separate vehicle for expanding on your personal views; it's simply a post that requires serving as the chief spokesman and the major representative for the Fed in the absence of the Chairman. The Chairman is the chief spokesman for the Federal Reserve System and represents the consensus views of the Board of Governors. Again it is the Vice Chairman's job to back him up.

Senator PROXMIRE. I'm interested to hear that and, frankly, I'm happy to hear you say twice in your response, that you believe the role of the Vice Chairman is to back up the Chairman. I think that that's very important. I think it's so important that the Board does act with consensus. And I'm glad to see that you recognize that and I think that all of us admire and respect Paul Volcker—I'm sure you do. He's demonstrated, I think, in his term as Chairman of the Federal Reserve Board a remarkable understanding of our economy and a successful administration of the Board, along with his colleagues, that broke the back of inflation.

I think in doing so, he's won the support of the American business community. I think it's important that we sustain that faith as long as the Chairman deserves it, and I think he does deserve it.

Let me ask you one other question. I want to get back very briefly to the questions that the chairman was asking about the increase in the money supply. And I thought your answer was an interesting answer and an answer that many people would accept. I'm not sure that I do.

M1 GROWTH OF 13 PERCENT IN 1 YEAR

The money supply, as measured by M1, has grown by 13 percent over the last year, 18 percent over the last 3 months since you've been on the Board.

If you take out the NOW accounts, the increase has not been much different than it's been in the past. However, I think that

you'd have to acknowledge that to take them out would distort the figures because many people, obviously, when they got the opportunity to receive interest on their transaction balances, naturally kept them in the form of NOW accounts.

So it seems to me that we have had both a super inflationary fiscal policy with enormously high deficits and a highly inflationary monetary policy. And while we've been fortunate for many reasons that you understand probably much better than I do that we have not had an inflation—in fact, inflation has moderated—it seems to me that we are building trouble for the future.

We have to be very careful, it would seem to this Senator, to be cautious about increasing the money supply much more as time goes on.

Dr. JOHNSON. Well, I agree with that. I think we do have to be very careful. And I think we are sensitive to the fact that—I mean, we're not comfortable with the fact that M1 has grown strongly, but I think failure to acknowledge the behavioral reasons for the strong growth in M1 could seriously weaken the economy if we tried to restrain an increase in demand for the savings component.

If we try to resist that, we run the risk with such a depressed velocity of actually pushing the economy into a seriously weakened situation.

On the other side of that coin is the potential that this potential liquidity built up in M1 could be used for transactions purposes and lead to an overheating in the economy.

And that's why I think we have to constantly monitor these other indicators of the economy's performance to get some idea of what this source——

Senator PROXMIRE. May I interrupt?

Dr. JOHNSON. Yes.

Senator PROXMIRE. The problem here, of course, is the big lag, isn't it?

Dr. JOHNSON. Yes.

CONCERN PREDICATED ON LAG DATE

Senator PROXMIRE. The great studies that have been made by Milton Friedman and others indicate that there's a lag that's maybe 18 months or 2 years. So that policies of expanding the money supply wouldn't be felt with inflation for a couple of years off—until after the next election, usually. And for that reason, there's very little concern in the Congress and there's not as much concern, in my view, as there should be on the Federal Reserve Board.

Dr. JOHNSON. I think that we're aware of the lags. One of the problems is that, as you know, the money supply has grown at fairly rapid rates at different times over the past 4 or 5 years, and yet, the lagged effects never materialized.

We've had such change in the relationship of M1 to inflation and the economy in general that even at times when we should be seeing the effects of a 1- or 2-year lag on the inflation rate, in fact, didn't, primarily for the reasons that I've indicated—that the source of M1 growth turned out to be in the interest-bearing com-

ponent of M1 that turned out to be not so much a transactions account, but a savings vehicle.

The point you make is well taken, though, that you can't simply relax and ever say that, well, this is permanently a savings component, because people can write checks on those accounts, even though they bear interest and there's always the potential.

If long-term interest rates go up at some point in the future indicating rising inflation expectations, individuals may say, well, I don't want to leave my money in a checking account any more in the form of savings. Either I want to move it into a higher interest-bearing, long-term instrument, or I want to spend this money because I'm worried about what inflation might do to my money drawing fairly low yields.

So I think that there's always a potential problem that has to be guarded against. But the risk is symmetric. I mean, the risk is that if we overreact to the M1 growth given the weak velocity situation that we've seen over the last 4 or 5 years, we could also seriously harm the economy.

So there is a fine line that you have to follow and I wish our tools were more precise. But I think you can get a fairly good indication on the lags by looking at some of the leading indicators like, in fact, the leading indicators of the economy or sensitive commodity prices or exchange rates.

Obviously, the fact that the dollar has depreciated 30 or 35 percent against trade-weighted currencies makes us even more sensitive to the growth in M1, because there is that potential for import price increases to filter through to the general price level. But at the same time, commodity prices are still fairly weak and the economy is sluggish and long-term interest rates have actually come down relative to short rates, not an indication of rising inflationary expectations.

If that were to turn around, we would have to be much more concerned about the growth in M1.

Senator PROXMIRE. My time's up, but the chairman has graciously permitted me to ask one final question, and you can give a brief answer.

Are there any areas where you've revised your views given your experience to date on the Federal Reserve Board?

Dr. JOHNSON. I don't know if I've really revised my views, but I've certainly had an awakening to some aspects of the job. When you go to the Federal Reserve Board, it's not like any other office. When I was at the Treasury, you could often make remarks about the economy and not really worry about anyone deciding to trade in the market based on my statement.

And so, to some extent, there wasn't the accountability that there is at the Federal Reserve Board.

Now, you find that the markets are much more sensitive to what you might say. So I guess I've been a little bit humbled by the experience. So you'll probably see fewer quotes from me in the future. [Laughter.]

The CHAIRMAN. Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman.

I was going to ask another question, but on the basis of what you just said, if you do not want to answer it, I would understand per-

fectly because of your position in the Federal Reserve, and you are supposed to be one of the monetary experts of America.

EFFECTS OF TAX REFORM BILL

Late at night this week, and probably next week, the U.S. Senate is working on a new comprehensive tax bill to bring the rates down to the lowest levels, I guess, in years and years and years.

Monday night, I attended a roundtable of business leaders, top business leaders in the country in my own State, and the feeling is just about universal that if we get these tax rates down and more incentive for people to earn, that our economy is going to have a renewed vigor for the next generation.

Would you comment on that?

Dr. JOHNSON. Yes. I think what the Senate's doing for tax reform is a really courageous act, given all the powerful special interest groups in the country. And at the same time, I think it's absolutely the right thing for the country.

If we could get top rates down to the 27-percent range and level the playing field by avoiding a lot of the tax preferences that exist in the system that cause resources to be allocated according to tax treatment rather than market forces, this would be a very important achievement.

There are so many details associated with this tax reform, I can't say that I've thought through every specific feature. But I certainly think that trying to level the playing field and getting the rates down substantially is going to be a major benefit for the economy.

I think that this makes the job at the Federal Reserve Board easier rather than more difficult. One of the areas that's being addressed in tax reform is the large tax preference for taking on debt.

Because of the deductibility of consumer interest payments and other interest payments on debt, the Tax Code has subsidized the demand for credit and expanded credit use beyond where it otherwise would be.

I think that even though the tax reform bill only partially addresses this issue, it's a step in the right direction, in constraining some of the tax-preferred use of debt. At the same time, the lower rates encourage savings. Even though there is a partial repeal of the IRA, that's been offset by the lower rates, the 27 percent.

My own opinion is that IRA's have been good for the country and I'd hate to see them go. But, in order to hold tax reform together at these low rates, it may be worth it.

So I think you're doing two important things. You're increasing the after-tax return to savings, which should encourage the supply of savings in the economy, and at the same time, you're eliminating partially the tax preferences for the incurrence of debt, and this should help interest rates adjust downward some.

Senator HECHT. Thank you. I read your qualifications. I'm very impressed. And I won't ask you any other questions.

But I do appreciate the way you answered that question. It was an off-the-shelf question and you answered very forthright.

I'm looking forward to working with you.

Dr. JOHNSON. Thank you, Senator.

The CHAIRMAN. Senator Dixon.

Senator DIXON. Thank you, Mr. Chairman.

First, Mr. Ryan, I want to tell you that I've had some good comments about you from an Illinois banker who dealt with you when you were with Gulf & Western. Since we ordinarily get letters critical of people when they're before us, I'm pleased to pass that information along to you.

Dr. JOHNSON. Thank you very much.

Senator DIXON. Mr. Ryan, a number of people, including Chairman Volcker, believe that the fall of the dollar over the past year may not lead to any swift improvement——

[Pause.]

Senator DIXON. I certainly blew that one. [Laughter.]

But if you were Mr. Ryan——

[Laughter.]

Dr. JOHNSON. That's all right. He sounds like a good fellow. [Laughter.]

Senator DIXON. I certainly hope there's some Illinois banker that thinks well of you. [Laughter.]

Dr. JOHNSON. So do I. [Laughter.]

Senator DIXON. Let me tell you something. You look like such a nice fellow, I'm going to try to find one. [Laughter.]

Dr. JOHNSON. OK. Thank you.

Senator DIXON. I'll try again with the question, if you're prepared for it, now that we've had this shakey start.

Dr. JOHNSON. OK. [Laughter.]

Senator DIXON. A number of people, including Chairman Volcker, believe that the fall of the dollar over the past year may not lead to any swift improvement of the U.S. trade deficit. It may even worsen it in the short term. Their argument is that it's possible that Americans may continue to buy the same amount of foreign goods, but with the dollar falling, foreign goods would cost more and therefore, the trade deficit would increase.

I'd like to ask you what your view is regarding the relationship between exchange rates and our trade deficit.

SO-CALLED J-CURVE EFFECT

Dr. JOHNSON. Well, that phenomenon that you mentioned has traditionally been referred to as the J-curve effect, where, the initial effect of a decline in the exchange rate is for the price of foreign goods to go up, but contracts still in place simply reprice those goods at higher rates and therefore, imports go up rather than down temporarily.

That is the traditional experience, so you have to be willing to be patient with an adjustment in the exchange rate to see the improvement in the trade balance.

The dollar has depreciated for a period of time long enough now, to see the other side of this so-called J-curve effect.

We're expecting to see the good side of the depreciation in the dollar in terms of rising exports and moderated demand for imports. And I think that we are in the initial stages of seeing those positive elements.

However, we shouldn't be overenthusiastic about what we can expect from just the change in the exchange rate alone, but cer-

tainly, a depreciation of the dollar to current levels is going to be beneficial in the terms of trade.

Even more important than the exchange rate itself is the growth rate of our trading partners. In other words, it doesn't do much good to improve the relative prices of domestic goods relative to foreign goods with the exchange rate if there's no growth in income among our trading partners to produce the demand for our exported goods.

One of the issues that concerns us today is that growth among our industrial trading partners is weak to the point of maybe not seeing the rise in demand for our exports that we would expect to see and we may not realize all the benefit of the exchange rate adjustment that we'd like because of this.

The OECD estimates for growth among the industrial countries has been around the 4-percent range. But we've seen first quarter growth rates in both Germany and Japan that have been very weak. The data coming out of West Germany indicates their first quarter growth rate was a minus 1 percent at a quarterly rate, and Japan is showing similar weakness. And there is some concern that the demand for exports will not be strong enough, even though the exchange rate is now, at an acceptable level.

That's one of the reasons why we have tried to encourage domestic improvements in growth among our industrial trading partners, because we've got to have a market for our exports, as well as improvement in the relative prices.

Senator DIXON. I want to tell you, Mr. Johnson, that you're almost as impressive to me as Mr. Ryan. [Laughter.]

Dr. JOHNSON. Thank you very much.

Senator DIXON. I want to thank the Chair for giving me this opportunity to mess things up. [Laughter.]

[The complete prepared statement of Senator Dixon follows:]

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the committee considers the nominations of Manual Johnson to be Vice Chairman of the Board of Governors of the Federal Reserve System and William Ryan to be first Vice President of the Export-Import Bank of the United States.

I know both nominees are well qualified for the positions to which they are nominated. I would just like to take this opportunity to say to Mr. Ryan that I have heard good things about him from an Illinois Banker who dealt with him when he was with Gulf & Western. In the Senate, we more often receive letters criticizing nominees than endorsing them, so this kind of endorsement speaks highly of him.

I look forward to hearing from both nominees on the challenges they will be facing when confirmed, and on their views on pending financial institution and trade issues.

The CHAIRMAN. Mr. Johnson, Senator Gorton had to leave to go to a markup in another committee. He does have an opening statement that we'll put in the record.

OPENING STATEMENT OF SENATOR GORTON

Senator GORTON. Mr. Chairman, as you know, I was one of the two Senators on this committee who voted against Governor Johnson's appointment to the Federal Reserve Board. I voted against the Governor because of policy disagreements I have with him, not because I doubt his abilities. On the contrary, I find him to be extremely able.

Since his appointment, a number of economists and journalists have commented favorably on Mr. Johnson's record during the first few months of his tenure, in spite

of the so-called "gang-of-four" incident last February. One such article, which appeared in the Wall Street Journal on May 14, says that Mr. Johnson "has displayed an extraordinary ability to get along with, earn the respect of, a wide variety of powerful people." This article specifies that Mr. Volcker is among these people. It goes on to say that the Governor recognizes that "it's impractical to apply rigid, ideological 'rules' to Fed policy." These are impressive statements, and I take note of them.

I continue to have disagreement about certain views Mr. Johnson has expressed in his previous confirmation hearing, and I welcome this chance to pursue those disagreements with him.

My disputes with the nominee have mainly to do with his views on fiscal policy. The Vice Chairman of the Federal Reserve Board will face many macroeconomic issues, the foremost being questions of monetary policy, but I believe that in these times of high Federal budget deficits, any Vice Chairman will have influence in all areas of macroeconomic policy, including fiscal issues. I believe I must have confidence in the views of any nominee to the Vice Chairmanship of the Federal Reserve Board.

Mr. Johnson has in the past indicated that he assigns little weight to the notion that budget deficits affect interest rates. He has also indicated his conviction that the strength of our economy and this country's political stability have been the primary cause of capital inflows and trade deficits, as opposed to our inordinate budget deficits. Finally, he has indicated that he is not troubled by the long run implications of the increasing ownership of American capital investment by foreigners.

While these propositions are, of course, clearly arguable, I have serious reservations about each of them, and have a great deal of trouble persuading myself to support a nominee for such a vital position who espouses them.

I am looking forward to again hearing the Governor's views in light of the current economic situation, and beyond these, I am looking forward to hearing his insights into the "gang-of-four" episode of last February.

The CHAIRMAN. In addition, he would like you to respond to some questions in writing because of his inability to stay.

Dr. JOHNSON. Absolutely.

The CHAIRMAN. We thank you very much for coming. I would expect swift approval of your confirmation.

Dr. JOHNSON. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much.

[Biographical sketch of nominee and response to written questions of Senator Gorton follow:]

61-558 0 - 86 - 2

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Johnson (LAST) Manuel (FIRST) Holman Jr. (OTHER)

Position to which nominated: Vice Chairman, Board of Governors of the Federal Reserve System Date of nomination: May 12, 1986

Date of birth: 10 (DAY) February (MONTH) 1949 (YEAR) Place of birth: Troy, Alabama

Marital status: married Full name of spouse: Mary Lois Wilerson Johnson

Name and ages of children: Marshal Johnson, 8 Merritt Johnson, 4

Education:

Institution	Dates attended	Degrees received	Dates of degrees
University of Alabama	1967-68	N/A	N/A
Troy State University	1971-73	BS	8/10/73
Florida State University	1973-77	MS, Ph.D	8/22/75, 12/16/77

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Green Beret; Ranger Tab; Parachute badget; Jungle Expert; Good Conduct Medal; Korean Service Medal; B.S. degree with honors (Cum Laude); Omicron Delta Epsilon (Economic Honor Society); Doctoral Dissertation Fellowship (Nuclear Regulatory Commission); Labor Economics Prize (best research paper in labor economics); Honorary President, Troy State University; Alumnus of the Year 1982 (Troy State University); Honor Award for Outstanding Contribution to Public Policy (Florida State University); Secretary's Honor Award for contribution to first foreign targeted securities issue (U.S. Treasury Department).

Doctor of Laws, Honorary Degree, Troy State University; Distinguished Alumni Award, Florida State University; Omicron Delta Kappa, Leadership Fraternity, Troy State University; Phi Kappa Phi, Academic Honorary Fraternity, Troy State University.

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
Kappa Alpha Order		1967-1968
Omicron Delta Epsilon	Vice-President	1974-1977
American Economic Assn.		1974-1981
Southern Economic Assn.		1976-1981
Western Economic Assn.		1976-1985
Public Choice Society		1978-1981
Regional Science Assn.		1977-1979

(Continued on attached sheet)

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

2/7/86 - Present, Board of Governors of the Federal Reserve System, Washington, D. C., Member

12/10/82-2/6/86 - U.S. Treasury Dept., Washington, D.C., Assistant Secretary for Economic Policy

7/27/82-12/10/82 - U.S. Treasury Department, WAshington, D. C., Assistant Secretary (Designate) for Economic Policy

2/2/82-7/27/82 - U/S. Treasury Dept., Washington, D. C., Acting Assistant Secretary for Economic Policy

4/27/82-2/2 /82 - U.S. Treasury Dept., Washington, D.C. Deputy Assistant Secretary for Economic Policy

1/24/77-3/31/81 - George Mason University, Fairfax, Va., Professor of Economics

9/14/73-12/31/76 - Florida State University, Tallahassee, Fla., Instructor and Research Associate

Continuation of Listing of Membership and Offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Association of Environmental & Resource Economists - 1979-1981 - No Office Held.

Philadelphia Society - 1980 to present - No Office Held.

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Board of Governors of the Federal Reserve System, Member;

U.S. Treasury Department, Assistant Secretary for Economic Policy;

U.S. Treasury Department, Assistant Secretary(Designate) for Economic Poli

U.S. Treasury Dept., Acting Assistant Secretary for Economic Policy;

U.S. Treasury Dept., Deputy Assistant Secretary for Economic Policy;

Commissioner, President's Commission on Indian Reservation Economies;
Member, President's Steel Advisory Committee

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

See attached list.

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Republic National Party

Pike County, Alabama Republican Yough Chairman, 1972

Troy State University Chairman, Students for Winton Blount for
U.S. Senate, 1972

Scholars for Reagan/Bush, 1980

BOOKS AND MONOGRAPHS PUBLISHED

The Effect of Deficits on Prices of Financial Assets: Theory and Evidence, U.S. Treasury Department Monograph, Washington, D.C.: U.S. Government Printing Office, March, 1984.

Deregulating Labor Relations, (co-author), Dallas, Texas: The Fisher Institute, 1981.

Better Government At Half The Price: Private Sector Production of Public Services, (co-author), Ottowa, Illinois: Caroline House Publishers, 1980.

The Political Economy of Federal Government Growth, (co-author), College Station, Texas: Texas A & M University, 1980.

Pushbutton Unionism, (co-author), Fairfax, Virginia: Contemporary Economics and Business Association, George Mason University, 1980.

Demographic Trends in Higher Education: Collective Bargaining and Forced Unionism?, (co-author), International Institute for Economic Research, University of California, Los Angeles, 1979.

An Assessment of the Impact of Nuclear Power Plant Construction and Operation on Small Regions, U.S. Nuclear Regulatory Commission NUREG Series, Springfield, Virginia: National Technical Information Service, 1978.

PUBLICATIONS IN PROFESSIONAL JOURNALS

"Union Use of Employee Pension Funds: An Overview," (co-author), Journal of Labor Research, Fall, 1981.

"Regional Environmental and Economic Impact Evaluation: An Input-Output Approach," (co-author), Regional Science and Urban Economics, Fall, 1981.

"Tax Limitation Without Sacrifice: Private Sector Production of Public Services," (co-author), Public Finance Quarterly, October, 1980.

"The Future of the Modern University," (co-author), Journal of Social and Political Studies, Fall, 1980.

"Natural Resource Scarcity: Empirical Evidence and Public Policy," (co-author), Journal of Environmental Economics and Management, September, 1980.

"The Efficacy of Bond-Financed Fiscal Policy," (co-author), Public Finance Quarterly, July, 1980.

"Increasing Resource Scarcity: Further Evidence," (co-author), Quarterly Review of Economics and Business, Spring, 1980.

"The Impact of Right to Work Laws on the Economic Behavior of Local Unions: A Property Rights Perspective," Journal of Labor Research, (co-author), Spring, 1980. This paper received the Labor Economics Prize awarded by the Center for Study of Public Choice for the best research paper on labor issues.

"An Abstract Approach to the Relative Ranking of Economic Journals," (co-author), Nebraska Journal of Economics and Business, Spring, 1980.

"Mathematics and Quantification in Economic Literature: Paradigm or Paradox?" (co-author), Journal of Economic Education, Fall, 1979.

"Quantification and Rigor in the Periodical Literature: Trends and Implications," (co-author), Akron Business and Economics Review, Fall, 1979.

"Free Riders in U.S. Labor Unions: Artifice or Affliction?" (co-author), British Journal of Industrial Relations, July, 1979.

"Paperwork and Bureaucratic Behavior," (co-author), Economic Inquiry, July, 1979.

"Laws of Committee Organization in Bureaucracy," (co-author), The Bureaucrat, Summer, 1979.

"Staff Spending by U.S. Senators: Liberals Versus Conservatives," (co-author), Policy Review, Summer, 1979. This paper was featured in the April 11, 1979 issue of the Wall Street Journal.

"Corporate Contributions: Some Additional Considerations," (co-author) Public Choice, Spring, 1979.

"U.S. Energy Policy and the Energy Crisis: Cause or Cure?" (co-author) Policy Review, Spring, 1979.

"An I-O Model of Regional Environmental and Economic Impacts of Nuclear Power Plants," (co-author), Land Economics, May, 1979.

"Public Versus Private Provision of Collective Goods and Services," (co-author), Public Choice, Winter, 1979.

"The Political Economy of Federal Government Paperwork," (co-author), Policy Review, Winter, 1979. This paper was featured in the lead editorial of the February 12, 1979 issue of the Wall Street Journal.

"Illegal Aliens: Economic and Social Issues," (co-author), Akron Business and Economics Review, Fall, 1978.

"The Energy Crisis in the U.S.: An Economic Perspective," (co-author), Journal of Social and Political Studies, Fall, 1978.

"The Definition of Bureaucrats by Bureaucratic Definitions," (co-author), The Bureaucrat, Spring, 1978.

"Bureaucratic Imperialism: Some Sobering Statistics," (co-author), The Intercollegiate Review, Winter, 1977-78.

OTHER PUBLICATIONS

"The Treasury Flat-Tax Plan: Analysis and Comparision," Cato Journal, a symposium entitled "The Flat Rate Tax: An Idea Whose Time Has Come?", sponsored by the Policy Sciences Program at Florida State University, forthcoming.

"Effects of the Monetary and Fiscal Policies of Industrialized Countries on Capital Flows and International Interest Rates," Financial Development of Latin America and the Caribbean, Caracas, Venezuela: International Institute of Capital Markets, 1985.

"The Stability of Monetary Velocity: Fact or Fiction?" (co-author), Research Paper Series, U.S. Treasury Department, August, 1984.

"The Recession of 1981-82: A Supply-Side Perspective," Explanations of the Business Cycle, Norman B. Ture, ed., Washington, D.C.: Institute for Research on the Economics of Taxation, 1983.

"The Flat Tax and Government Growth," The Family and the Flat Rate Tax, Bill Gribbin, ed., Reston, Virginia: American Family Institute, 1983.

"The Administration's Economic Policy: Its Effect on Construction," The Military Engineer, May-June, 1983.

"Economic Forecasting and the Federal Budget," A Reconstruction of the Federal Budget, Princeton University: The Committee for a Responsibl Budget, 1982.

"Public Policy for a Growth Economy: Graduation Address to the Troy State University School of Business," Great Issues, Troy, Alabama: Troy State University Press, 1982.

"The Reagan Economic Recovery Program," TSU Business and Economic Review, July, 1982.

"Are Monetarism and Supply-Side Economics Compatible?" Supply-Side Economics: A Critical Appraisal, Richard H. Fink, ed., Frederick, Maryland: University Publications of America, 1982.

"Private Sector Unions in the Political Arena: Public Policy Vs. Employee Preference," (co-author), Public Policy Analysis and Management, Richard Zeckhauser, ed., Duke University Press, 1982.

"Review of Basic Economics by Edwin G. Dolan," American Economics Texts: A Free Market Critique, James Taylor, ed., Young America's Foundation, 1982.

"Mises on Bureaucracy," History of Economics Society Bulletin, Spring, 1979.

"Paperwork and Public Policy," (co-author), Policy Report, September, 1979.

"Illegal Aliens: Problems and Policies," Legislative Analyses, American Enterprise Institute for Public Policy Research, September, 1978.

"The Renegotiation Reform Act of 1977," Legislative Analyses, September, 1977.

Estimated Historical Impact of Deteriorated Water Quality on United States Coastal Fishery Resources, (co-author), Florida State University, December, 1974.

Adaptation to a Non-Growth Status, Tallahassee, Florida: The State University System of Florida, December, 1973.

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None

Qualifications: State fully your qualifications to serve in the position to which you have been named.
(attach sheet)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

N/A

I may retain my extended leave of absence, without pay, from George Mason University.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

If I retain my extended leave of absence with George Mason University may return as professor of economics after government service.

3. Has anybody made you a commitment to a job after you leave government?

George Mason University has offered to extend my leave of absence without pay.

4. Do you expect to serve the full term for which you have been appointed?

Yes.

Qualifications

Board of Governors of the Federal Reserve System

Since February of this year, I have served as a member of the Board of Governors of the Federal Reserve System and have become familiar with the responsibilities of both Board members and the Vice Chairman.

For the past five years, I was directly involved with monetary and fiscal policy in the Federal government. As Assistant Secretary of the Treasury for Economic Policy during this period, I often worked closely with the Governors of the Federal Reserve Board and their staff. A primary function of this office was to advise the Secretary of the Treasury on all monetary affairs. Therefore, I met weekly with Federal Reserve Board officials to discuss the most pressing issues of financial policy. My duties also required that I serve on the economic forecasting troika (Treasury, Office of Management and Budget, and Council of Economic Advisers) which prepared projections of the economy's performance for estimation of the President's annual budget proposals. Over the course of my tenure at Treasury I have had first-hand experience with the operation of Federal government debt financing and its relationship with monetary policy. In addition, I have participated in development of Administration policies on financial sector regulation and supervision, international lending, and exchange rates.

Prior to my public service with the Treasury, I was a professor of economics at George Mason University in Fairfax, Virginia. During my tenure as a university professor I taught numerous courses in economics and extensively researched a host of topics such as macroeconomics in general and monetary and fiscal policy in particular (see attached list of publications).

If confirmed, I shall do my very best to serve the Nation well as the Vice Chairman/Member of the Board of Governors of the Federal Reserve System.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None

3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None other than participation at the U.S. Treasury in development and advocacy of Reagan Administration economic policies.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

None

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

Governor Johnson's responses to questions
from Senator Gorton submitted in connection
with nomination hearing held on June 12, 1986

Question: 1.) Mr. Johnson, would you please explain your outlook for inflation in this country for the next six months to a year.

Answer: I believe the basic outlook for inflation over the next six months to a year remains favorable. In recent months, the sharp drop in the prices of petroleum products has held down, and in some cases led to outright declines, in the major measures of inflation. Although overall price increases should pick up once the direct influence of the oil price declines has subsided, inflation is likely to remain at or even below rates posted in recent years. The indirect effects of lower energy prices on businesses' costs should continue to alleviate pressures on prices over the next year. In addition, recent wage developments also are encouraging. Thus far this year, underlying wage trends have remained well-behaved, with most measures indicating that wage inflation has posted some further deceleration from the moderate rates recorded last year. Moreover, expectations of future inflation, which are an important element in the determination of wages, still seem relatively moderate.

Nevertheless, a major concern surrounding the outlook for inflation is the course of the foreign exchange value of the dollar and its attendant effect on the prices of internationally traded goods. The decline in the dollar that has occurred since early 1985 has apparently boosted the prices of some imported goods in recent months and seems likely to place some upward pressure on consumer prices over the next year. However, the existing margin of unused capacity, particularly in the domestic manufacturing sector, should help to contain these pressures.

Over time, even further progress toward price stability should enhance the performance of the economy. A stable price level will create an environment in which economic decisions are free of the distorting effects of inflation, and economic growth can more readily be sustained.

Question: 2.) Mr. Johnson, as you know, the budget committees of the House and Senate are currently working towards a budget resolution which will meet the Gramm-Rudman-Hollings budget targets for fiscal year 1987. This will require significant budget cuts -- or, in economic jargon -- fiscal restraint. What, in your view, is the proper monetary course to follow for the next year in light of your expectations for inflation and this fiscal restraint?

Answer: Gramm-Rudman-Hollings is a positive development for the conduct of monetary policy because it reduces expectations that pressure to finance the budget deficit will cause the Federal Reserve to monetize the debt. Lower inflationary expectations have reduced the inflation and risk premiums on interest rates and caused the velocity of money (M_1) to weaken. Households and businesses have become more inclined to leave their earnings in checking deposits because lower inflation slows the decline in purchasing power and because competitive interest earnings are available. As this change in behavior occurs, more money supply growth is required to yield the same GNP. The adjustment in monetary policy would be technical rather than stimulative but it would reinforce the decline in interest rates.

The resulting decline in deficit spending due to Gramm-Rudman-Hollings should not produce a depressing effect on the economy that would justify aggressive monetary ease since total demand is not affected. Less federal spending is offset by less borrowing from the private sector -- government has less disposable income but private households have more.

Question 3.) Mr. Johnson, would you please explain your role in the gang-of-four incident, and how you think future disputes of that nature might be handled?

Answer: Assuming the "gang-of-four incident" refers to the February 24th discount rate vote, my motives for supporting a reduction in the discount rate at that time were purely based on policy considerations. Declining oil prices, progress with Gramm-Rudman-Hollings, and continued modest growth in the economy had begun to change financial market psychology. Long-term interest rates were falling relative to short-term rates indicating a decline in inflationary expectations. Also, monetary velocity (M_1) was continuing to decline indicating a need for stronger money growth in order to maintain GNP.

It was clear that our major trading partners, Germany and Japan, needed to lower their discount rates even more than the U.S. These countries had built up large trade surpluses over the last few years while the U.S. acquired a large trade deficit serving as the World's engine for growth. The oil price decline improved fundamental economic conditions in Germany and Japan relative to the U.S. because they were total oil importers. Nonoil producer prices were also declining in both countries. Germany had an unemployment rate that still exceeded 9 per cent. Finally, both Germany and Japan had appreciating currencies relative to the U.S. dollar. All Federal Reserve Board members favored a lower discount rate under these circumstances, however, there was considerable debate over the timing of such a move. Because the dollar was showing weakness against the mark and yen, some Board members felt strongly that the Federal Reserve could not afford to lower interest rates in the U.S. unless Germany and Japan cut their rates first.

Although I personally felt that this view was correct, there was little evidence at the time that Germany or Japan intended to take action to lower their discount rates. Therefore, I decided that it was necessary to go ahead with a discount rate reduction in the U.S. in hopes that Germany and Japan would follow quickly in order to stabilize their exchange rates. However, when it became obvious that both Germany and Japan would take action to lead a coordinated discount rate reduction, I quickly supported a deferral of the Board's vote until after official announcements abroad. Ultimately, the Board voted unanimously to cut the discount rate on March 7th.

Question 4.) Mr. Johnson, please explain your views on the role of budget deficits on the order of those this country has experienced for the last several years in the economy -- both from a domestic and international perspectives.

Answer: The role of federal budget deficits over the last several years is an extremely complex issue. There are no simple answers to this question because there are so many economic variables involved with changes in the budget deficit. Probably the best way to explain my views on the subject, both from a domestic and international perspective, is to submit to you my previous testimony before the Joint Economic Committee and a comprehensive study I prepared while at the Treasury Department. These two documents are attached for your evaluation.

Attachments (2)

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 10:00 a.m.
Friday, October 21, 1983

STATEMENT OF MANUEL H. JOHNSON
ASSISTANT SECRETARY FOR ECONOMIC POLICY
BEFORE THE
JOINT ECONOMIC COMMITTEE

Introduction

Good morning, Mr. Chairman. It is a pleasure to appear before the Joint Economic Committee in response to your invitation to testify on the subject of the relationship between Federal budget deficits and interest rates.

I would like to begin my testimony with a summary of Federal budget deficit projections. Then I shall summarize some results of mainstream macroeconomic theory and empirical research regarding the relationship between budget deficits and interest rates and economic growth. I would also like to briefly reflect on possible policy measures to deal with these deficits.

Projected Deficits

The table appended to my testimony shows Federal budget deficits projected through FY 1986 in both billions of dollars and as a percentage of GNP. Estimates are given for both the

First Congressional Budget Resolution and the Administration's Mid-Session Review of the FY 1984 Budget. In the interest of comparability I have used CBO's estimates as they appear in CBO's The Economic and Budget Outlook: An Update, August 1983. It should be noted, however, that more recent preliminary estimates indicate that the FY 1983 deficit may come in substantially below the mid-session estimate of $210 billion and that the FY 1984 deficit estimate may also prove to be too high. Also, for your information, I have included the revenue and outlay numbers upon which the deficit estimates are based. Although the current debate often is carried on only in terms of the deficit, it is obvious that the deficit is simply a residual, the difference between revenues and outlays. This latter pair of quantities describes the Federal programs which the Congress must enact. Also, experienced analysts realize that the economic effect of a given deficit is likely to depend on the size of outlays relative to GNP, the composition of outlays and the kind of taxes levied.

A quick look at the table shows that unified budget deficits are expected to be large through FY 1986, but they are projected to decline both in absolute terms and as a percentage of GNP. A similar story is told by CBO's estimates of a so-called "standardized" deficit, calculated on the basis of an economy operating at 6 percent unemployment. For the three-year period FY 1984-86, the standardized deficit is estimated to be $99, $110, and $87 billion, respectively -- or 2.6, 2.7 and 2.0 percent of GNP. The difference between actual and standardized deficit projections

is roughly the amount of deficit due to underutilization of productive capacities and is commonly regarded as of less concern than the structural deficit.

Deficits, Macroeconomic Analysis and Ambiguous Results

Traditionally, in popular discussions, deficits have been viewed as affecting primarily macroeconomic targets of aggregate demand and price stability. Recently the role of budget deficits as automatic or discretionary countercyclical stabilization tools has become controversial. Moreover, questions about the effects of government deficit spending on long-term real economic growth have become a focus of attention and contention.

The discussion about the consequences of budget deficits for economic growth often is phrased in terms of their effects on prices of goods, services and, especially, such financial variables as interest or exchange rates. An examination of frequently encountered assertions about the causal links between deficits and interest rates reveals that, contrary to some widely publicized opinions, the effect of government deficits is by no means unambiguous. The outcome depends, among other things, on the assumption made about the saving behavior of the private sector. One framework of analysis notes that when taxes are cut and government borrowing is increased by an equal amount, some (perhaps all) of the tax cut will be spent on new government bonds.

The total amount of the tax cut will be used to purchase the new bonds if the taxpayer/bondbuyer perceives that the bond

interest he receives will be used to pay the future tax required to service the government debt, and that the return of the principal of the bond will be used to pay the future tax required to retire the bond. In this case, leaving aside incentive and distributional effects, there is no impact on the interest rate whether government spending is financed by taxes or borrowing. This view, while still controversial, is not new -- it dates at least from David Ricardo in the early 19th century. And several recently completed empirical studies suggest support for this hypothesis.

The extreme opposite assumption is that there is no substitution whatsoever between taxes and borrowing by the government; extra after-tax personal income is devoted entirely to increased consumption, none is saved. Thus, no increase in private saving accompanies the additional government borrowing and thus the additional demand for loanable funds inevitably results in upward pressure on interest rates.

Other factors that exert crucial influence on the outcome are the extent to which: deficits are caused by spending increases or tax cuts; financing is accomplished by monetization of the debt or by sale of government debt to the public without new money creation; the tax cut reduces marginal tax rates thus improving incentives to supply productive labor and capital; the outlays financed by the deficits change the composition of government spending; and government debt is an attractive investment for foreigners.

The results are also influenced by the magnitudes of the private sector's various responses to the specifics of the policy changes and a host of institutional arrangements determining the adaptability of labor, product and asset markets to changing economic conditions.

These considerations indicate that short-term consequences of budget deficits may be very different from the long-term ones. I shall devote a few remarks to both.

Short-term Financial Effects

Some concerns about the impact of budget deficits on interest rates focus on very short-term financial effects, which, even if they do in fact occur more or less systematically, are of very short-lived and reversible nature. A surge in Treasury borrowing may raise interest rates briefly. However, at most it can be said that this temporary rise reflects the reaction of financial markets to short-term excess flow demand for credit that must eventually (and rather rapidly) be eliminated by adjustments in the size and composition of accumulation of financial assets by the private sector.

These very short-run effects are, while clearly of great significance to participants in financial markets, have minimal influence on the longer-term evolution of real economic variables and are, therefore, of relatively minor importance for formulation of economic policy.

Effects of Deficits on Cyclical Recovery

Some analysts assert that high current deficits will prevent or abort the ongoing economic recovery. The argument behind this

assertion is that big deficits cause high interest rates; high interest rates depress expenditures for output of interest sensitive industries; and the economy cannot recover unless those industries recover.

In discussing the cycle, it is clear that "passive" deficits which are the result of recession are matched by a decline in private sector borrowing, and are not likely to raise interest rates or prevent recovery. What seems to be at issue is the impact of "active" deficits which go beyond the normal cyclical levels due to deliberate policy changes.

The conditions under which big deficits do or do not cause high interest rates will be discussed in a few moments.

But even assuming that big deficits do cause high interest rates, this need not derail the recovery. Reduced demand for some categories of output may be more than offset by larger expenditures for other categories of output (such as consumption of nondurables or defense spending). The strength of recovery depends on total production and sale of goods and services rather than particular categories of goods and services. In fact, it is widely recognized that an "active" deficit adds to total spending and thus aids the recovery to proceed apace. Depending on economic conditions (including the rate of money growth), the current deficit may put some upward pressure on interest rates or other prices. However, this would indicate that there is more than enough, rather than too little, aggregate demand relative to the available supply of goods and services.

There is no economic theory to support the assertion that a large current deficit will depress the economy. And, Alan Sinai's recent DRI study shows that a sustained reduction in the deficit particularly with no acceleration in money supply growth will reduce real GNP for a three-year period. At most, a large deficit that adds to total spending and thus contributes to an upward pressure on the interest rate may also contribute to a bias in the composition of total demand against the output of interest sensitive industries, such as, for instance, housing. The extent to which this bias will be pronounced is an empirical matter.

Another assertion is that large expected future deficits will prevent the recovery. The argument behind this assertion is as follows. Future deficits make expected future interest rates high. That keeps present long-term interest rates high, because today people will not lend long term at rates that are below the rate they expect to obtain several years from now.

One version of the argument is that prospective deficits result in higher expected inflation, which results in expected higher nominal interest rates in the future, thus causing higher nominal rates now. But even if future deficits cause higher expected inflation (which is by no means self-evident), this argument implies that nominal -- not real -- interest rates rise. However, in a rational world high nominal rates should not restrain investment unless expected real rates also rise.

Effects of Deficits Over the Time Span of a Business Cycle

The foregoing discussion of the likely effects of government deficits on the prospects for recovery assumes, albeit not without

caveats, that government deficits are responsible for high interest rates. However, the extent to which deficits affect interest rates in the medium term is a question for which mainstream conventional economic theories have only ambiguous answers.

Perhaps the most widely-used approach for analyzing intermediate-run effects of deficits on interest rates is the Keynesian theoretical framework in which an increase in the deficit brought about either by an increase in government spending or a reduction in taxes has the effect of raising interest rates. This happens because an increase in the deficit leads to an increase in aggregate demand, and hence, in nominal GNP. The increased dollar volume of transactions requires more money. If the Fed does not accommodate the increased demand for money, the velocity of circulation must rise, a result which is made possible by a rise in interest rates. It may be noted that in the Keynesian framework higher interest rates are associated with higher GNP, which is quite different from an assertion that high interest rates prevent GNP from rising.

Now, I would like to say a few words about the connection between deficits and the rate of inflation. Although deficits can be observed to rise while the inflation rate falls, it is possible that an increase in the deficit can put some temporary upward pressure on the price level even if the deficit is not monetized.

With no supply-side effects considered, an outlay increase or a tax reduction, resulting in an equal increase in the deficit,

causes a temporary increase in inflation, a permanent rise in the price level and in real interest rates, and a permanent decline in investment. The price pressure will be self-terminating if monetary policy remains unchanged.

Acceleration of money growth, in an attempt to counter the upward pressure on real interest rates, would prolong and accelerate the rate of inflation. Evidence on the extent to which deficits have been monetized is mixed, but there are some data that at least suggest that in recent U.S. history there has been a positive relationship between the percentage increase in the privately held Federal debt and the rate of growth of the monetary base. However, earlier this week, in his appearance before the House Banking Committee, Chairman Volcker offered assurances that the current large Federal deficit would not affect monetary policy.

Crowding Out

Another critique of fiscal policy characterized by large deficits emphasizes the so-called "crowding out" effect of excessive government borrowing.

The term "crowding out" is used loosely in popular discussions to convey the notion of a displacement of private investment by government absorption of real credit. But this notion is misleading and the concept of crowding out is murky.

Because credit is scarce, it is rationed by capital markets, and so even if government is totally absent from capital markets, some potential borrower is crowded out at any level of interest rates. Crowding out thus occurs in the process of market allocation of limited credit to the users able to pay the highest

prices. But if, for instance, increased government borrowing is due to a corporate tax cut, cash flows internally generated by corporations will increase, and their credit demands will decrease commensurately. Also, the financial market process of crowding out does not contain any normative implications: that is, for a given level of government spending no general assertion can be made that financial crowding out is more deleterious to the economy than alternative methods of financing a given level of government expenditures.

The unique role of the government in crowding out other potential borrowers is not due to the sheer size of its credit demands. Rather it mainly reflects the facts that the government borrowing is interest rate insensitive, and that the government borrows to finance activities that predominantly do not add to future productive capacity. Since government spending is, from the standpoint of generating future growth, mainly nonproductive, it preempts some resources which otherwise could have been used for investment purposes. Rather than a financial phenomenon, the reduction in private investment and consumption reflects the resource allocation required when increased government expenditure demands compete with private investment and consumption for limited amounts of labor, capital and other productive inputs. Preemption of these productive factors by the government is sometimes labeled real, as distinct from financial, crowding out. Thus, apart from incentive effects, the impact of government spending on the economy in the medium term is the same

independently of whether this preemption is financed by borrowing or by taxes.

It is also worth noticing that crowding out by the government, be it financial or real, need not necessarily have its major impact on business investment rather than households' consumption. All that can be said is that interest-sensitive spending by the private sector is reduced relative to noninterest-sensitive expenditures.

Incentive Effects

Incentive effects -- the increase in the supply of productive factors caused by improved incentives resulting from cuts in marginal tax rates -- are most important when the tax cuts are permanent. A tax cut financed by government borrowing may be viewed as temporary to the extent that the borrower expects that tax rates will be raised to retire the debt originally issued to finance the tax cut. Thus, a tax is more likely to be viewed as permanent when accompanied by a reduction in government spending. To the extent that a tax cut enhances economic growth, government borrowing to finance the tax cut will be less likely to crowd out private investment. This is because higher growth means, first, more tax revenues to partly offset initial revenue losses, and, second, more saving to meet the additional supply of government bonds. Therefore, there would be less upward pressure on real interest rates and on prices, resulting in more private investment and a different consumption pattern.

Short Remarks on the Long Run

Finally, I would like to offer a few brief remarks on the connection between government deficits and prices (including

interest rates and exchange rates) in the long run. This problem is analytically very interesting, empirically intractable and extremely important from the standpoint of formulating appropriate policies.

One can only speculate on the effect of continuing deficits on interest rates and, more fundamentally, on economic growth.

In brief, for some combination of elasticities of supply of labor and private savings, a given structure of marginal taxes, a composition of government expenditures (in terms of growth-enhancing and growth-retarding categories), and other parameters, there will be some sustainable level of secular budget deficits relative to GNP, that is, essentially, not resulting in an explosive growth of the debt-to-GNP ratio. It is not possible to state a priori what that level might be but it need not necessarily be zero. The sustainable deficit-to-GNP ratio would be higher the greater are, among others, the responsiveness of supply of labor and savings to net rates of return; marginal output-to-labor and output-to-capital ratios; average marginal taxes; and the proportion of productive investments in total government spending. But satisfactory econometric estimates of these parameters do not exist yet.

However, simulations (performed by IMF economists among others) based on a range of reasonable values of relevant parameters indicate that the effects of tax rates cuts on the supply of aggregate output, while rather weak in the short run, may, in the long run, dominate the demand, i.e., the stimulative,

effect. Therefore, it appears that the secular trend of deficits, if kept at a sustainable level may be more conducive to economic growth than if the corresponding amount of funds was raised by taxing the productive factors in the economy.

Finally, even if one were to accept the proposition that continuing high deficit-to-GNP ratios cause high interest rates, one could not conclude that these high interest rates will unavoidably result in slow economic growth. If tax cuts and tax reforms geared toward creating economic incentives, rather than increases in non-productive government spending, are the prime reason for deficits, high real interest rates may have no discernible effects on the rate of economic growth. In fact, evidence abounds that during periods of economic buoyancy and optimistic expectations, as, for instance, in the 1920s and 1960s, high investment levels and concomitant high growth rates may prevail for long stretches of time despite high (real) interest rates and, vice-versa, low (real) interest rates prevalent, for instance, in the 1970s by no means guarantee high investment levels or robust growth.

Empirical Studies

The theoretical analysis presented so far indicates that the effects of an increase in the deficit upon interest rates are ambiguous; larger deficits can coincide with either higher or lower interest rates.

Econometric -- statistical -- attempts to discern systematic relationships between deficits and real interest rates (while

controlling for other influences such as the growth of money, business cycle effects, and effects of risk due to volatility in money growth) have failed to establish reliable evidence of such a relationship. Consider, for example, two recent studies by researchers who represent somewhat different approaches to macroeconomic analysis: Princeton University Professor Alan Blinder and Ohio State University Professor William Dewald who is editor of the Journal of Money, Credit, and Banking. If you like labels, Blinder is a Keynesian, while Dewald is a monetarist.

Dewald, in a January 1983 paper published by the Federal Reserve Bank of Atlanta, concludes that, "the high real interest rates in 1981 and 1982 are attributable to much higher and particularly much more variable inflationary expectations than normal," and, he continues, there are "a variety of credit market factors" which "offer a more promising explanation of high real interest rates than budget deficits which have been found to account for very little of recent high real interest rates."

In his December 1982 National Bureau of Economic Research Working Paper, Blinder says that on the basis of his statistical analyses, "The hypothesis that growth in debt does not help predict real GNP growth cannot be rejected" and "in sum, neither growth in bank reserves nor growth in national debt carries much information that is useful in predicting future real GNP growth."

A recent study by University of Rochester Professor Charles Plosser finds that increases in government spending raise interest rates, whether financed by borrowing or taxing.

He finds that substituting taxing for borrowing to finance the same level of government spending has little impact on bond prices or interest rates. Thus, to reduce interest rates, spending must be cut.

As you may know, Mr. Chairman, we at the Treasury are in the process of completing a comprehensive review of the set of issues I discussed in my testimony. This review will contain an annotated bibliography of academic literature on the subject, a critical analysis of relevant empirical work, and our own attempts to statistically identify determinants of interest rates. Your staff expressed interest in the monograph we are preparing and I would like to offer it for the record when it is completed.

Conclusion

Even though the relationship between the deficit and real interest rates and economic growth remains an open case, I am seriously concerned about future deficits because they are projected to be too large a share of GNP even though tax receipts are simultaneously projected to be at or near historically high levels -- between 19 and 20 percent of GNP. In this situation my conclusion is that Federal outlays must be trimmed. I prefer this course for several reasons.

First, a tax increase may simply buy more spending rather than less deficit. For example, the Administration consented to a $100 billion tax increase in TEFRA in exchange for nearly $300 billion in outlay reductions. Initially, only $53 billion in spending cuts were voted by the Congress. Subsequent budget

resolution reclaims even those cuts and projects spending increases of about $114 billion.

Second, a tax increase probably would not be effective in reducing interest rates. Moreover, a business tax increase would have a direct and adverse effect on investment spending by reducing the rate of return on plant, equipment, and structures, while an individual income tax increase would discourage investment by small unincorporated businesses, and would reduce savings and raise labor costs, which would also retard investment and growth.

The case for raising taxes is based on the assumption that it will cause saving and investment to expand relative to consumption spending. The theoretical analysis and empirical evidence on this supposition is not convincing, and I believe that my skepticism is warranted.

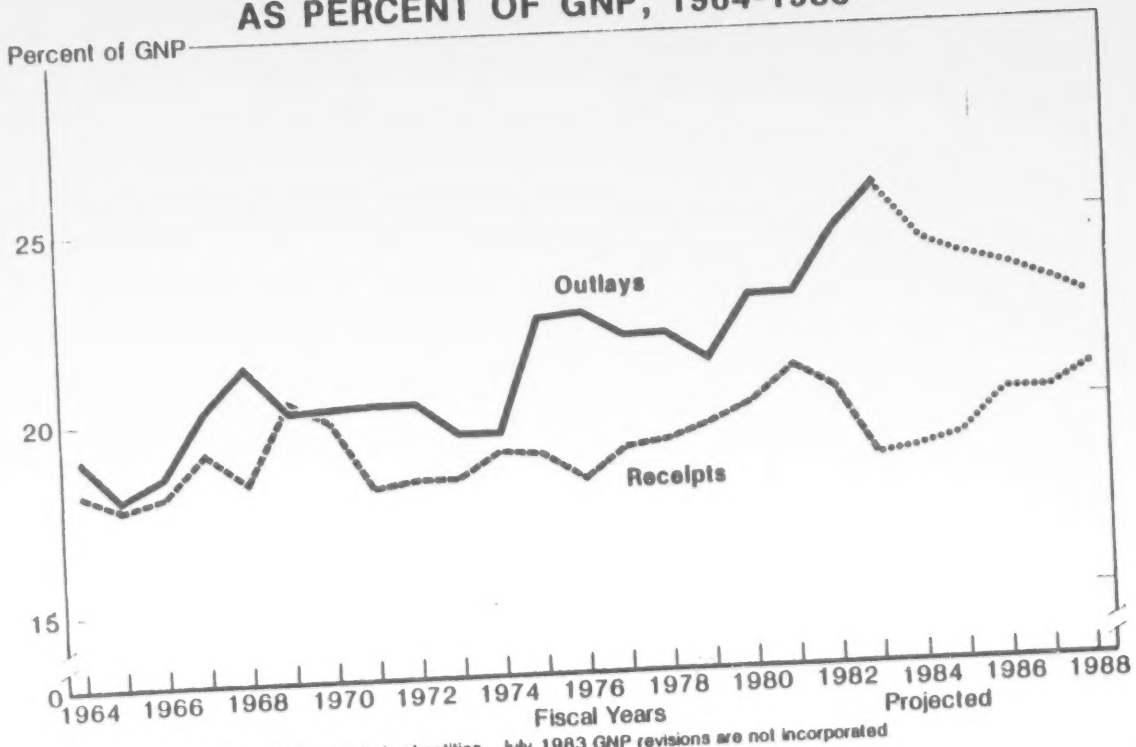
In my opinion the growth of Federal outlays should be slowed so that it runs about 20 or 21 percent rather than close to 25 percent of GNP. This goal should be the first priority of the Congress as it considers spending legislation in the current fiscal year.

Table 1

Comparison of CBO Projections of the Budget Deficit
Under the Resolution and Administration Policies
(by fiscal year, in billions of dollars)

	1983	1984	1985	1986
Deficit:				
Budget Resolution Policies				
Including Reserve Fund	$206.5	$191.6	$180.4	$146.4
Excluding Reserve Fund	206.5	182.7	176.1	142.8
Percent of GNP	6%	5%	5%	3%
Administration Policies	$206.5	$180.9	$178.5	$144.6
Outlays:				
Budget Resolution Policies				
Including Reserve Fund	$807.0	$869.0	$929.0	$989.0
Excluding Reserve Fund	807.0	860.0	924.0	986.0
Percent of GNP	25%	24%	24%	23%
Administration Policies	$807.0	$849.0	$917.0	$988.0
Revenues:				
Budget Resolution Policies	$600.0	$677.0	$748.0	$842.0
Percent of GNP	19%	19%	19%	20%
Administration Policies	$600.0	$668.0	$739.0	$843.0

BUDGET OUTLAYS AND RECEIPTS AS PERCENT OF GNP, 1964-1988



Note: Outlays include off-budget federal entities. July 1983 GNP revisions are not incorporated

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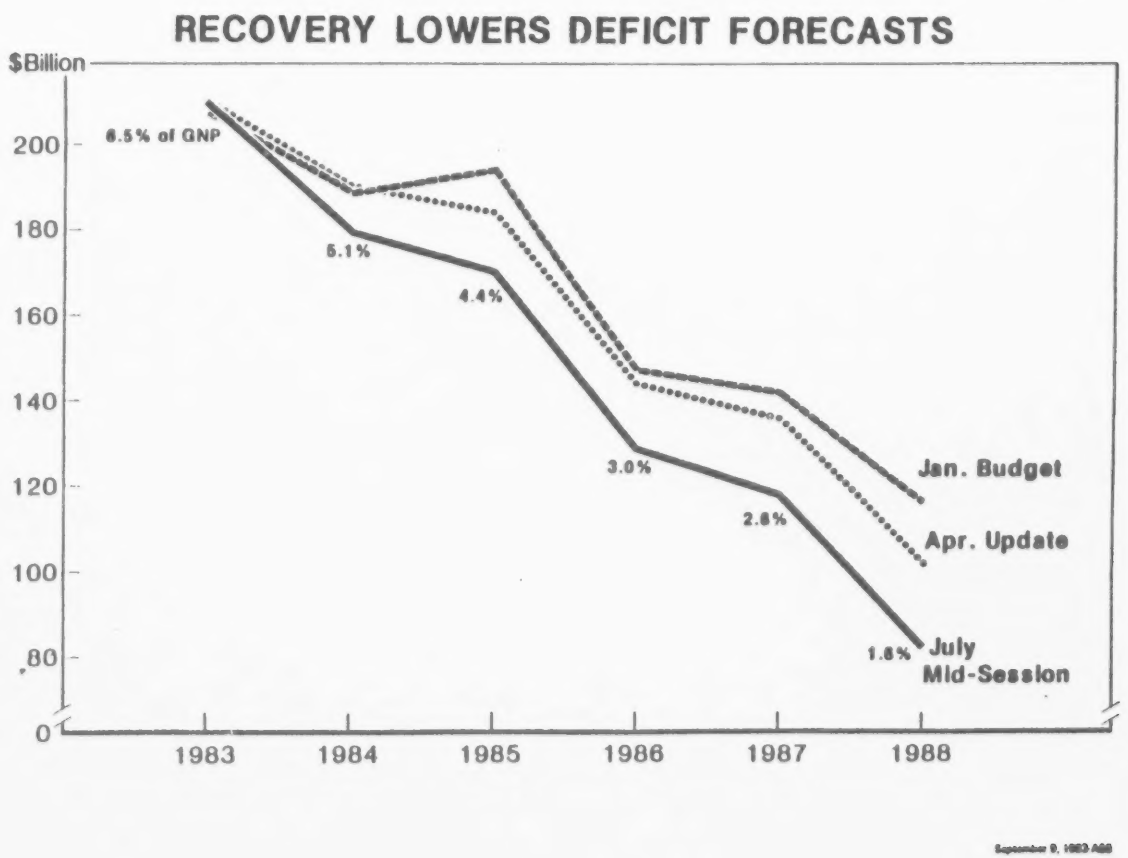
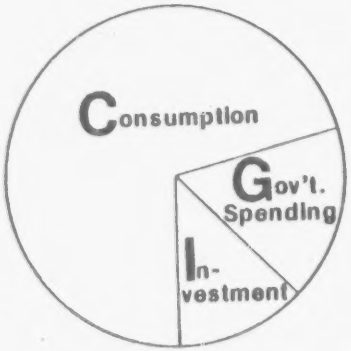
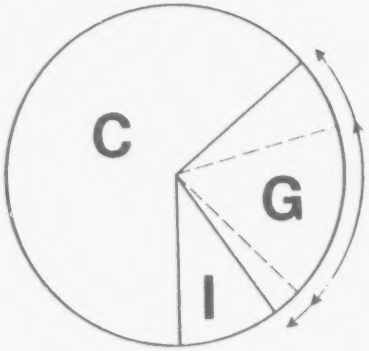

RECOVERY LOWERS DEFICIT FORECASTS
$Billion
200
180
160
140
120
100
80
0
6.5% of GNP
5.1%
4.4%
3.0%
2.6%
1.8%
Jan. Budget
Apr. Update
July
Mid-Session
1983
1984
1985
1986
1987
1988

GOVERNMENT SPENDING DOES THE "CROWDING OUT"

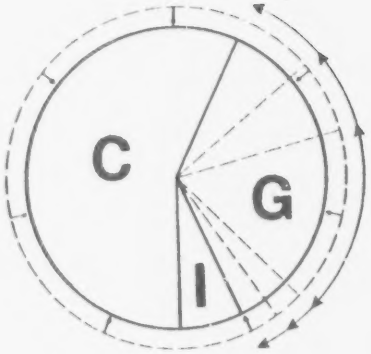
The Pie



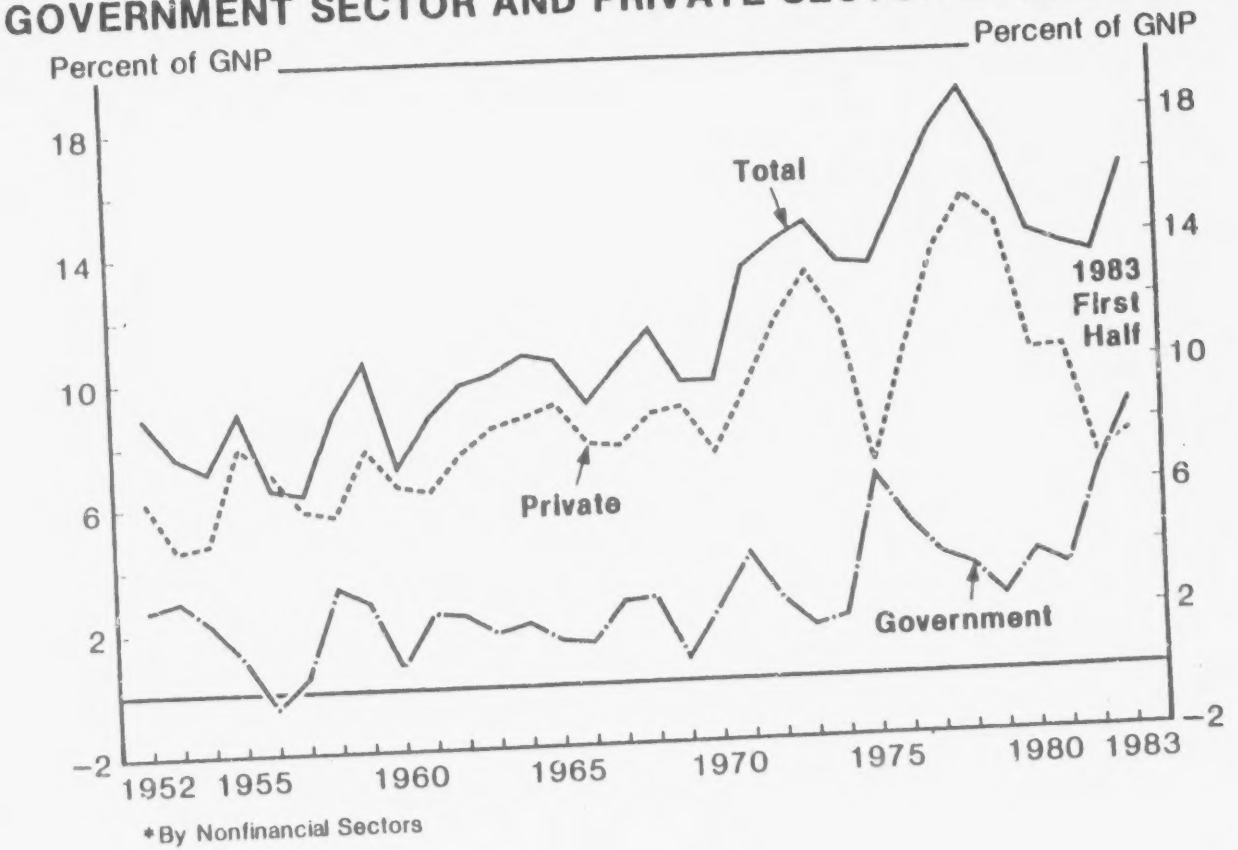
A Bigger Slice for Government, Smaller Slices for Consumption and Investment



Result: A Shrinking Pie, an Even Bigger Slice for Government

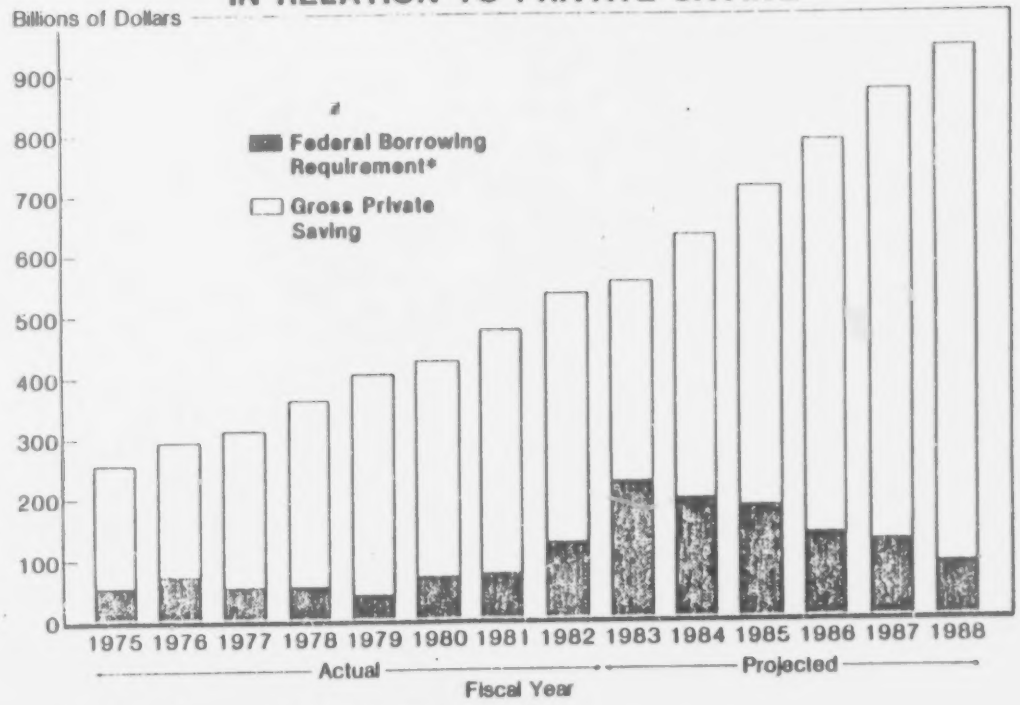


GOVERNMENT SECTOR AND PRIVATE SECTOR BORROWING*



*By Nonfinancial Sectors

PROJECTED BORROWING REQUIREMENT IN RELATION TO PRIVATE SAVING

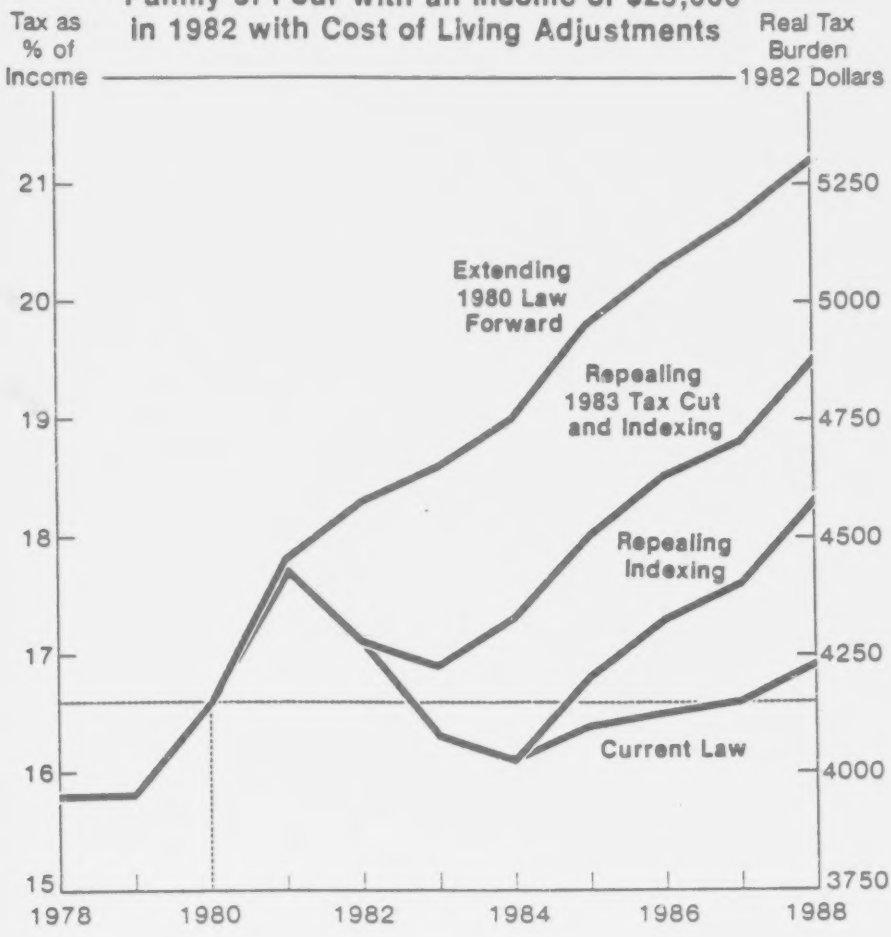


*Total budget deficit including off-budget entities.

Note: Saving flows do not reflect surpluses of state and local governments or inflows from abroad. Figures are based on July 1983 Mid-Session Budget and economic projections. Does not incorporate July 1983 GNP revisions.

REAL TAX BURDEN
(INCOME & EMPLOYEE PAYROLL TAX)

Family of Four with an Income of $25,000 in 1982 with Cost of Living Adjustments



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Question 5.) Mr. Johnson, What caused the dollar to rise and stay so strong early in the decade? Why has it fallen so substantially? What has the role of the G-5 been in the fall of the dollar?

Answer: The dollar's rise from late 1980 through early 1985 was probably attributed to many factors: the relative vigor of the U.S. economy and the related profitability of real investment in the United States; a renewal of confidence in the purchasing power of the dollar, following the disastrous period of high inflation; and, "safe haven" considerations, especially after the onset of the international debt crisis. Even after giving due weight to all of these factors, part of the dollar's rise, particularly in late 1984-early 1985, appears "unexplainable" by ordinary economic and political factors.

The dollar's decline after early 1985 appeared to be due to a reversal of several of these same factors -- especially, perhaps, to the persistence of slower growth in the U.S. economy after mid-1984. There may also have been an element of pricking a speculative bubble.

The G-5 announcement in September, backed by heavy official sales of dollars, may have contributed to the further decline of the dollar since last fall, by focusing the market's attention on recent changes in economic fundamentals which, the participants believed, warranted significantly higher values for major foreign currencies against the dollar. In particular, the G-5 announcement pointed to the greater convergence of economic performance among major countries.

The CHAIRMAN. The Banking Committee will continue to consider the nomination of William Frederick Ryan.

Are you paying attention, Senator Dixon. [Laughter.]

Senator DIXON. I'm catching on slowly, Mr. Chairman. [Laughter.]

The CHAIRMAN. We now have Mr. Ryan coming before us.

Senator DIXON. I just want to tell you, Mr. Ryan, that there's an Illinois banker [laughter] and I'm delighted to pass that along to you, personally.

Mr. RYAN. Thank you. I appreciate that. [Laughter.]

The CHAIRMAN. Mr. Ryan, we're happy——

Senator DIXON. I'm glad we got that settled. [Laughter.]

The CHAIRMAN. We're happy to have you before us this morning to be nominated for the position of first Vice President, and Vice Chairman, of the Export-Import Bank of the United States.

May I have you stand and be sworn?

[The nominee is sworn.]

STATEMENT OF NOMINEE WILLIAM F. RYAN

The CHAIRMAN. Mr. Ryan, do you have an opening statement you wish to make?

Mr. RYAN. No, Mr. Chairman. I'd just like to say that it's a privilege to appear before this committee, before you, and it will be a privilege to serve at the Export-Import Bank, if you confirm me.

The CHAIRMAN. Senator Dixon, Mr. Ryan. [Laughter.]

Senator DIXON. Well, Mr. Ryan, I just want to repeat one more time for the benefit of the chairman of this committee, who probably hasn't been paying much attention to all this, that there's a banker in Illinois that did business with you when you were at Gulf & Western. He's written me an outstanding letter, telling me what a fine man you are.

We so seldom get complimentary letters concerning nominees, I wanted to pass that along to you. I'm not going to ask you any questions because you and I are now in a good position and I want to keep it that way. And I want you to know that I'm going to vote for your confirmation.

Mr. RYAN. Thank you, Senator. [Laughter.]

Senator DIXON. And I thank the Chair.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman. No questions. I'm very impressed with Mr. Ryan's background. I've enjoyed meeting him personally. I feel confident he'll do an excellent job.

The CHAIRMAN. Mr. Ryan, will you make every effort in your service with the Export-Import Bank not only to avoid conflicts of interest, but to avoid even the appearance of conflicts?

Mr. RYAN. Yes, sir.

The CHAIRMAN. Do you agree to appear and testify before this committee and other duly constituted committees of Congress when requested to do so?

Mr. RYAN. Yes.

The CHAIRMAN. Will you recuse yourself from any decision or action involving or specifically benefiting Gulf & Western Industries or the Bank of New York?

Mr. RYAN. Yes.

USE OF MIXED CREDITS BY OUR COMPETITORS

The CHAIRMAN. As this administration has succeeded in limiting competition in official export credit rates through negotiations at the OECD, we have seen competition shift into an increasing use of mixed credits by our competitors to win export sales. In this area, we have failed in negotiations to limit mixed credits in any significant way.

What do you think we need to do in order to bring an end to the use of mixed credit as a predatory trade practice?

Mr. RYAN. Well, Senator, you indicated the negotiations had failed thus far. I guess you mean they haven't necessarily succeeded thus far.

This is a subject on which I'm just sort of getting up to speed, if you will. I haven't been familiar with it in the past.

My understanding is that the OECD negotiations have been making, I would say, reasonable progress, in the sense that there's a recognition among all the major trading nations, the OECD nations, that mixed credits are expensive to the treasuries of the various countries concerned. There is, I understand, a sense of discipline coming into this practice among the various nations, and general agreement that, come October, when they sit down again to discuss this subject, that they will have done, all the nations involved, their staff work, their homework, and hopefully will come to a sensible agreement, arrangement, with regard to mixed credits: namely, to increase the required amount of subsidy element in those credits to—and we've been trying to get them up to 50 percent—my understanding is that they generally and informally have agreed to go to 35 percent, which makes that a pretty expensive proposition for anybody granting mixed credits in connection with an export sale.

Obviously, that isn't a done deal. We have to see how that works out. And I think our posture should be, well, we're making progress toward that goal. We all recognize what the problem is. We should, I think, as a bank, stand ready to meet—what should we say—outstanding examples of this kind of predatory financing.

As of now, as I understand it, we don't have the resources necessary to meet every one of these mixed credit situations, and it would be immensely costly to the taxpayer to do so.

Therefore, I think our posture should be between now and October to watch the situation carefully. If we see an egregious example of a misuse of these credits by one of the trading partners that's perhaps recalcitrant in the negotiations, that's holding out, and that should be legitimately a target for us to throw in a matching mixed credit, we should be prepared to do that.

I'm rather impressed—you know, I'm only beginning to catch up on the numbers of the bank—that we've already made since last September, when the President announced this type of tactic, this trade initiative, that we've already made about $400 million in offers of a mixed-credit type, that is, covering exports of that magnitude, which to me is at least using the tool that Congress has made available to us and the President has asked us to be alert to.

But my general feeling is we should watch it carefully between now and October and do everything we can to influence the trading partners to come to a sensible arrangement on these mixed credits. But not to meet every mixed credit as it comes down the pike.

GREATER SUPPORT OF EXIMBANK FOR EXPORTERS

The CHAIRMAN. At the beginning of each fiscal year, the Bank always comes before the committee and tells us that it will be able to use all of its direct loan authority. Yet, as the year progresses, the bank seems to fall far short of using its authority.

I have been an advocate of aggressive bank policies in all the 12 years I've been here to help our exporters. We hear complaints from businessmen that it's too difficult to apply for Eximbank support. The application procedure is too cumbersome. Loan officers are discouraging in their attitudes and so forth. And I share some of that view.

I'll be very frank with you, I have been frustrated with this administration's attitudes on the Export-Import Bank. I thought the Carter administration was bad and when my administration came in, I thought it would get better. It has not.

Yet we constantly hear about the great trade imbalance and so on, and yet, seem unwilling to push the Bank as hard as we should in helping our exporters.

What do you think can be done about that and what do you intend to try and do about that?

Mr. RYAN. Well, let me say first, Senator, I share, or did share, your general attitude toward the Bank. I must say my experience from the industry side working with the Bank is not recent. It goes back some years, more than 5 years.

My impression of the Bank going back to those years was of a rather stodgy, stuffy institution and a bit difficult to get to move and certainly to get to renegotiate things from time to time as that proved necessary.

I've been very agreeably surprised studying the Bank recently, meeting the people in the Bank, working informally thus far with Chairman John Bohn, that the Bank in recent years has become much more responsive, much more market oriented, and much more—what shall we say—sympathetic and positively supportive of the needs of our exporters.

I think that's the case, certainly in recent years, and certainly, that would be my objective, to make it as responsive as possible in the fight to preserve export markets and to gain export orders. No question about it.

The CHAIRMAN. Well, let's assume some of the mechanics have been improved. What about not using their direct loan authority?

OFFER OF $5 BILLION IN DIRECT LENDING PROGRAM

Mr. RYAN. Well, again, I'm not an expert in this area, but the little bit I've looked into the Bank, and I did study last evening, for example, the draft of the Bank's annual report for last year ending September 30—it will come out in the next week or so—and I'm rather impressed by a couple of things.

The Bank made offers—let's just take the long term and the Direct Lending Program—it made offers to finance about 5 billion dollars' worth of sales of various types of equipment, machinery, what have you. Rough numbers now: about $1 billion of that didn't take place. The orders, for some reason or another, did not materialize. The buyers put off the purchase. That left about $4 billion in which we had offers outstanding. OK?

Of that, surprisingly, the American companies bidding on those orders against the French, the Japanese, whoever, got more than 50 percent of the orders, on the order of $2.3 billion of that $4 billion of the orders that went forward. Very easily, those orders could have come in to us, or to the Bank, to be financed. As it turned out, 80 percent of those orders that went forward were financed in the private sector, which I think is a tribute to the efforts underway over the last few years to get the OECD so-called arrangement rates closer to market rates. That's by and large been pretty successful, I think.

And so a lot of these export orders, 80 percent of the ones on which we had offers outstanding were financed in the private sector, which is all to the good. I think everybody would agree that if the private sector will do it on as good terms as we've been offering, or other export agencies, that's a good thing.

That's going to lead this year to an undershoot, if you will, of the authority that we requested last year, or that the Eximbank requested. We won't use up the full authority. That doesn't mean that the Bank was not aggressive in trying to finance those exports. It does mean that with the way interest rates have moved over that period of time—interest rates, of course, were declining generally during that period—the private sector rates were more attractive than the OECD arrangement rates—the OECD arrangement rates are set every 6 months. So there's a lag in those rates that are set, by the way, on the 6 months' prior interest rates.

So a lot of that financing went outside to the private sector, which, again, is good. At least in the recent year that I've been looking at, I don't think it's been a lack of aggressiveness on the part of the Bank.

By the same token, Senator, the arrangement rates on July 15 will drop very significantly because they'll be set according to the market rates of the previous 6 months. If private sector interest rates go up significantly after July 15, we're going to find some of the export orders that last time financed in the private sector trying to come back to the Bank and use its resources.

There's no way of predicting and calling it exactly. But as far as I can see, there's not been a lack of aggressive interest and receptiveness to this type of financing.

The CHAIRMAN. Mr. Ryan, let me say this to you. I am impressed with your knowledge gained in a very brief period of time, but don't be too impressed or co-opted too fast.

INFLUENCE OF OMB ON EXIM

Go down there maintaining some of your attitudes of what it was like when you were a businessman and then I think you will be able to do a much better job. You will get into the details of all

these credits and see, how it works and the lack of aggressiveness. You're also going to learn very fast that, historically, there's been a problem with OMB. Even though the Export-Import Bank was established in 1945 as an independent agency of the Government, OMB has been sticking their nose into it, dictating policy. And some of your impression I'm sure is correct in that the Bank would like to do more. But OMB becomes more and more a bunch of numbers-crunchers. They punch buttons and numbers come out.

They don't seem to understand what the French do in predatory financing and the problems we have and what the large trade deficits do to us.

Watch out for OMB and some of these outside influences. Try and keep Exim an independent agency as Congress set it up and try and look at the need. What authority we give you, I would suggest that the Bank use. OMB should mind their own business, in this and other areas.

As you can tell, I'm not very happy with OMB in a number of areas lately. While the President wants a strong space program in the future, as an example, and we've argued for 4 or 5 months about whether we should have a replacement orbiter, OMB doesn't think we need one because they look at dollars. They're not looking at the future of space. They don't seem to look at the future of trade deficit in this country. It's just all dollars, right now in this budget, and they've got blinders on. They are green eyeshades, not very realistic about policy.

I guarantee you what they're going to come up with. They'll be pushed because the President wants a fourth orbiter. To show you the shortsighted thinking, they're going to come out and say we're going to buy a fourth orbiter.

And you know where they're going to get the money? By delaying the space station, because this set of OMB people won't be in in 1993 or 1994, when some new President and new administrator of NASA is before a congressional committee explaining why the space station costs a lot more than it was supposed to.

And it was because this OMB wanted to delay it to pay for an orbiter this year. OMB's got the same kind of shortsighted thinking in Export-Import Bank. They bear some of the responsibility for the trade deficit because of their head-in-the-sand, shortsighted, weasel thinking that goes on down in that particular body.

Senator D'Amato.

STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Well, Mr. Chairman, first of all let me commend to Mr. Ryan your admonitions with respect to OMB. Let me also welcome Mr. Ryan. I wish you the best of luck. You've got a distinguished background. I see at one time you were a New Yorker. I'm sorry that we lost you to New Jersey.

I guess you did what Don Regan said. He opted out for lower taxes, Mr. Chairman. [Laughter.]

But I'm sure you'll do an excellent job.

As an aside, I think OMB, in certain respects, is a menace and danger to the country. When they make these shortsighted cuts that the chairman has alluded to as it relates to space, that cer-

tainly, I think, does not demonstrate far sightedness. Their cuts in education, more particularly, their cuts as it relates to the criminal justice system and the battle that we're attempting to wage against the overwhelming menace of drugs, is absolutely unconscionable.

We now have a freeze on hiring in the Justice Department. In the eastern district of New York, probably the greatest area of drugs entering the country, the U.S. attorney is understaffed. They can't hire U.S. prosecutors, even though they're well within their budget, to undertake this battle.

So it's that kind of insensitivity, I think, that the chairman alludes to that you'll be faced with, and the battle to keep America——

The CHAIRMAN. I hit them over the head with it. [Laughter.]

Senator D'AMATO. In the battle to keep America competitive, they'll make this penny-wise and pound-foolish decision.

I second the chairman's strong admonition. Call them the way you see them. Don't become part of that march, because you wouldn't have been here and recommended and gotten here unless you probably gave strong signals during the political process, and they felt that you were going to march to a certain drumbeat.

Well, to be faithful to the administration is one thing, but sometimes you've got to tell your best friends, look, if you try to save this penny here, in the long run, it's going to be very costly to the efforts of the Nation.

So good luck to you.

Mr. RYAN. Thank you.

Senator D'AMATO. And I second the chairman's admonitions, or his warnings.

Mr. RYAN. Thank you, Senator.

The CHAIRMAN. Mr. Ryan, Senator Dixon had to leave. Senator Proxmire also had to go to the floor and he has some questions that he would like to submit to you for your response in writing.

[The complete prepared statement of Senator D'Amato follows:]

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Mr. Chairman, I want to welcome Mr. Ryan to the committee this morning to discuss certain issues that will confront him as first Vice President of the Export-Import Bank of the United States. Due to the unique role that Eximbank plays in export financing, Mr. Ryan will have a direct impact on the trade policies of the United States. In view of the unprecedented $150 billion trade deficit that the United States has accumulated, Eximbank's influence to help in reducing the deficit is heightened.

Mr. Ryan will be required to develop programs to meet the needs of the U.S. exporting communities—programs that will facilitate the exchange of commodities and maintain U.S. competitiveness in the world market. Such programs will be increasingly important to U.S. businessmen until the trade account becomes more balanced.

Mr. Chairman, Mr. Ryan's academic and professional accomplishments recommend him for the position to which he has been nominated. I look forward to working with him in the future.

Thank you, Mr. Chairman.

The CHAIRMAN. My only closing admonition would be to be a strong advocate for the exporters of this country.

Mr. RYAN. That's why I'm here, Senator.

The CHAIRMAN. Thank you very much.

Mr. RYAN. Thank you.

The CHAIRMAN. The committee is adjourned.

[Whereupon, at 9:58 a.m., the hearing was adjourned.]

[Biographical sketch of nominee, response to written questions of Senator Proxmire, and letter of support from Dean A. Gallo, U.S. Representative in Congress follow:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name RYAN (LAST) WILLIAM (FIRST) FREDERICK (MIDDLE)

Position to which nominated First Vice President and Vice Chairman Export-Import Bank of the United States Date of nomination April 23, 1986

Date of birth 27 (DAY) Jan (MONTH) 1926 (YEAR) Place of birth New York, New York

Marital status Married Full name of spouse Sheila Boarman Ryan

Name and age of children:

Mark	- 32	Susan	- 27
William	- 31	Robyn	- 26
Peter	- 29	Marshall	- 24

Education:

Institution	Dates attended	Degrees received	Dates of degrees
All Hallows Institute Bronx, N. Y.	1939-41	-	-
St. Joseph's High School West Park, N. Y.	1941-43	H.S. Diploma	June 1943
Fordham University New York, N. Y.	6/43-9/50	B. Sc.	Sep 1, 1950
Catholic University of Louvain, Louvain, Belgium	9/50-9/52	Bachélier en Philosophie*	June 25, 1951
		Licencié en Philosophie*	July 3, 1952

*Avec distinction

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

. New York State Regents Scholarship: 1943

. Belgian-American Education Foundation grant to study in Belgium: 1951-52

. Fulbright Act foreign study award alternate: 1951-52

. Commendation of National Alliance of Businessmen for volunteer work on JOBS Program: Dec 10, 1968

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
International Finance Group, N.Y.	-	1984-86
(Informal discussion group of international financial executives)		

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

See Attachment A.

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

None other than that shown in Employment Record.

Published writings: List the titles, publishers and dates of books, articles, speeches, reports or other published materials you have written.

"Cardinal Mercier: Man of Science" in Catholic World, Dec 1951.

"Managing Corporate Funds Internationally" at 8th Annual Financial Conference of The Conference Board, Feb 22, 1973.

"How Well are Fluctuating Exchange Rates Working?": Testimony before the U.S. Senate Subcommittee on International Economics, June 20, 197

"The International Monetary Role of Multinational Firms" at the Center for International Business, Graduate School of Management of UCLA, Nov 16, 1973.

"The Dollar and Multinational Business" at the 1985 Financial Outlook Conference of The Conference Board, Feb 20, 1985.

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Registered Republican throughout this period.

Sustaining member of Republican National Committee in 1985 and 1986.

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

Political Action Committee of Gulf + Western Industries, Inc.:

1984 $180 (through bi-weekly payroll deduction)

1985 $390 (" " " ")

1986 $ 45 (" " " ")

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See Attachment B.

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

I retired from Gulf + Western Industries, Inc. on 1/31/86 and have no continuing relationship, other than that described below, with any firm, association, etc.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

I have no such plans.

3. Has anybody made you a commitment to a job after you leave government?

No.

4. Do you expect to serve the full term for which you have been appointed?

Yes.

Potential conflicts of interest.

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

See Attachment C.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

Ownership of shares in Gulf + Western Industries, Inc. Stock option loan from The Bank of New York.

3. Describe any business relationship, dealing or financial transaction (other than tax paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

At Gulf + Western Industries, Inc. I recommended company contributions for the formation of the Committee for Employment through Exports and to the Trade '84 Conference sponsored by industry in celebration of the 50th Anniversary of Eximbank.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I will recuse myself from any decision or action specifically involving Gulf + Western Industries, Inc. and The Bank of New York as long as I own shares in the former or owe money to the latter in connection with these shares.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None.

ATTACHMENT A

EMPLOYMENT RECORD

Government

- Civilian Education Adviser - U.S. Air Force, Germany (9/52-11/54)
- Foreign Service Officer - U.S. State Department (11/54-2/62)
  - Intelligence Analyst - Washington (11/54-7/56)
  - Vice Consul & Commercial Officer - Southampton, England (7/56-7/58)
  - Political & Protocol Officer - U.S. Mission to UN, N. Y. (7/58-5/59)
  - Consul & Economic Officer - Melbourne, Australia (5/59-1/61)
  - Second Secretary & Administrative Officer - Canberra, Australia (1/61-2/62)

Banking

- Irving Trust Company, New York (2/62-5/68)
  - Assistant Vice President
    - liaison with Washington agencies and MDB's
    - international corporate finance
    - investments of international agencies (BIS, UN, IADB, World Bank, ADB)

Industry

- Allied Chemical Corporation, New York and Morris Township, N. J. (5/68-12/73)
  - Manager - International Finance
  - Director - International Finance
- Gulf & Western Industries, Inc., New York (12/73-1/86)
  - Director - International Finance and Special Projects
  - Director - Corporate Finance
  - Vice President & Treasurer
  - Vice President - Finance

ATTACHMENT B

QUALIFICATIONS FOR APPOINTMENT

The experience I have had in government service, banking and industry is, I believe, a good preparation for the job of First Vice President of Eximbank.

Eximbank's programs and activities bring together the concerns, interests and technical problems of the government, financial institutions and American industry in connection with financing our exports. I like to think that, having served in responsible positions in these three areas over the years, with special emphasis on international finance, I am equipped to understand those concerns, interests and technical problems and to help work out optimal solutions.

For some time I have been concerned about the impact of our international trade and overseas debtor problems on American industry and employment. My decision to take an early retirement from my company was motivated, at least in part, by a wish possibly to be of service to the Administration in this area. Eximbank has an important role to play here, and I was very pleased and honored to be nominated by the President to this assignment. If confirmed by the Senate, I think I can make a contribution toward making the financing facilities available to American exporters as responsive and competitive as any in the world.

ATTACHMENT C

As a retiree from Gulf & Western Industries, Inc., I am or will be receiving various benefits which are described in detail in the Confidential Financial Statement.

It appears rather remote that Gulf & Western Industries, Inc. will be affected by policies that I might influence at Eximbank. It has not used Eximbank programs in the last four years because of a lack of export business (other than film and TV product), and a new strategic plan for the company which resulted in the divestiture of the businesses which might be likely to use Eximbank export financing in the future. Its financial services subsidiary might in future participate in Eximbank financing.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM

WILLIAM F. RYAN

SENATOR PROXMIRE: I see from your resume that you recently served as Vice President and Treasurer of the Allied Chemical Corporation. I think that is an excellent background to bring to the Bank at this particular time as the Eximbank is going broke and your skills as a Treasurer could help it get back on a firmer financial footing.

As you might already know the General Accounting Office (GAO) annually examines the Eximbank's financial statements and has since 1975 been expressing concerns about the adequacy of the Bank's capital reserve in light of its declining income. In 1984 in order to ensure that the Bank does not go broke and leave the taxpayer holding the bag, I introduced legislation requiring the Bank to maintain a minimum level of capital stock and retained earnings in an amount not less than $2 billion. The bill authorized Congress to appropriate the funds the Bank would need to comply with that requirement. I asked the Bank to comment on my proposal. It said it did not think my legislation was needed because "all obligations of the Bank are obligations for which the full faith and credit of the U.S. government is pledged". In other words do not worry if the Bank is losing lots of money -- after all, the American taxpayer will be around to pick up whatever tab is ultimately run up.

Do you share the view of my proposed legislation expressed by the Bank in 1984, or do you believe we need to put the Bank on a pay-as-you-go basis now so the taxpayers are not someday required to bail it out with a massive and expensive rescue plan?

MR. RYAN: Senator, I have just begun to study seriously the question of the capitalization of Eximbank and the matter of accounting for subsidies, etc., in the U.S. Government system. I am not, therefore, an expert in this area as yet. That having been said, I cannot comment on your 1984 legislation with authority except to say the following: Eximbank is not a bank within the private or commercial sense of that term. It does not take deposits from the public or issue debt to private investors who have to make a credit judgment about the condition of the bank. It is an agency of the U.S. Government whose obligations are backed by the U.S. Government. It is carrying out a government function--the promotion of exports through competitive financing--and is not in the business to make a profit. I realize that in many years in the past Eximbank did make profits because it earned more from its loans than it paid on its obligations, and that was very gratifying at the time.

In recent years it has been losing money because it chose some years back to lock in to long-term financing from Treasury at unusually high interest rates, while continuing to make loans at interest rates that were set to be competitive in order to

help U.S. exporters win export sales--an important national objective. Those losses are not an accurate measure of the cost to the taxpayers, in my view.

In principle I certainly agree that the Congress and the taxpayers should know year by year, or on a pay-as-you-go basis as you have phrased it, what the costs, if any, is to the taxpayers of Eximbank's activities. In this connection I must say that I see a great deal of merit in Senator Heinz's recent bill (S. 2428) which outlines a completely new, to my knowledge, method of accounting for all of the Government's credit programs and which incorporates the idea of pay--that is, "appropriate"--as you go, and I plan to dig into the merits of this method in the coming weeks.

So to try to summarize: yes, I believe the reports of Eximbank should reflect year by year the cost to the taxpayers of carrying out its function. But I don't believe it is vital to maintain the capitalization of the Bank, capital plus reserves, at some arbitrary level.

SENATOR PROXMIRE: During this year's hearing on legislation to extend the Bank's Charter beyond its September 30, 1986 expiration date, a witness from the General Accounting Office said the Bank's annual financial statements present a misleading picture of its true financial condition because "they do not reflect losses likely to occur due to the probable uncollectibility of a significant portion of the Bank's loans that are owed and guaranteed by foreign governments."

The GAO witness went on to say that "the principle of recognizing loan losses in accordance with generally accepted accounting principles is well established for private financial institutions and should apply equally to government corporations such as the Export-Import Bank."

I have introduced a bill that is based on GAO's recommendation and which requires the bank to estimate its loan losses and deduct that amount from its retained earnings in accordance with generally accepted accounting principles.

Do you, as a former company treasurer, think the GAO recommendation [that the bank estimate its loan losses and deduct that amount from its retained earnings in acordance with GAAP] makes sense? If confirmed will you work to have the Bank agree to adopt the concept as a proper management principle?

MR. RYAN: Here again, Senator, I don't pretend to be an expert on Government accounting, but I do not accept blindly the idea

that the Government must keep its books in accordance with GAAP because private financial institutions do so. Eximbank is not a private financial institution raising its funds and accepting deposits from private investors. The objective in private and Government accounting should be, obviously, to describe revenues and costs accurately, and to present a true picture of the financial condition. The true condition of a Government agency, even one organized as a corporation, is quite a different thing from that of a private company or bank.

Now, naturally the recognized principles of GAAP should be adhered to as much as possible in a situation like that of Eximbank and the staff of Eximbank maintain that the Bank is indeed following GAAP in its accounting. The question of writing down sovereign risk loans is a very special one. The Bank staff would maintain that, even in this area, they are following GAAP, since FASB 5 on accounting for contingencies says you should write down loans, first, when you see a reasonable likelihood of not getting paid or getting paid less than face value, and, secondly, to the extent that you can reasonably estimate the amount you are likely to lose on those loans.

The Bank's position, which is, I understand, the Government-wide position with very important policy implications, is that it does expect to be paid back on these loans even though it may take, in some cases, a long time and a number of reschedulings.

Here again the difference between a bank that is a Government agency and a private commercial bank is very important. Eximbank is not trying to mislead investors. On the contrary, it clearly lists the delinquent loan and interest payments in its balance sheet for all to see, and schedules out those loans very completely in its financials.

So, in answer to your question, Senator, I will certainly work on the question of the capitalization of the Bank and the appropriate accounting of its activities to the Congress and the taxpayer. Indeed, Mr. Bohn has already asked me to study this question closely as a matter of priority and I will be doing so.

SENATOR PROXMIRE: As a follow up to my prior question I note that the GAO witness at our February hearing said "one significant result of not recognizing loan losses is the potential impact on congressional oversight. As shown on its statements, the Bank's financial position does not appear as severe as it is in reality and the Congress may be led to make policy decisions that it would not otherwise make were the Bank's true financial condition fairly presented."

Do you think that is a valid point? If the Bank does not keep honest books according to generally accepted accounting principles how can Congress really carry out its responsibilities as to the Bank's operations?

MR. RYAN: I think I have given you my views already in answering the previous two questions. As far as I can see the Bank does keep honest books according to GAAP and neither the Congress nor the taxpayer is being deceived, in my view. The question of how much, if at all, the activity of Eximbank is costing the taxpayer through the subsidization of export loans, guaranties and insurance is, it seems to me, a Government accounting problem to which you and Senator Heinz have given a great deal of thought and which might be well addressed in the context of Senator Heinz's bill (S. 2428).

SENATOR PROXMIRE: The New York Times recently reported that a federal grand jury in Pittsburgh has begun an investigation into allegations that the Westinghouse Corporation made an $80 million payment to a close associate of President Marcos in order to win a competition with General Electric for a $1.1 billion contract to build the first nuclear power plant in the Philippines., According to the New York Times article Westinghouse has acknowledged that it paid a commission to Mr. Hermino T. Disni, a relative of Mr. Marcos' wife Imelda - but has not said how much it paid.

The Times article also notes that the Export-Import Bank provided $227 million in direct loans and $676 million in loan guarantees to help Westinghouse win the project. This all happened in 1976, prior to the enactment of the Foreign Corrupt Practices Act, which has been so helpful in curbing the practice of corporate bribery as a way to win contracts.

I understand however that even prior to the FCPA's enactment the Bank had policies in effect to make sure it did not fund export sales won by bribes and that Westinghouse certified to the Bank in a July 27, 1976 letter that it had not made any bribes in order to obtain the Philippine nuclear power contract.

Can you tell us whether if that certification was false Westinghouse can be criminally prosecuted and if so under what statute the Bank can sue Westinghouse to obtain a refund of the hundreds of millions of dollars that Eximbank spent building that Philippine nuclear plant that will never go into operation? Are there any statute of limitation problems with either civil or criminal prosecution?

I don't expect you to have the answers to these legal questions today, but I would like you to give us a written answer

for the record as soon as possible. Also I would like to know whether you believe the Bank should obtain reimbursement from companies of any money spent by the Bank based on a material false certifications given by the applying company.

MR. RYAN: Before responding to the specifics of the Westinghouse case, I would like to discuss Eximbank's general procedures with regard to payments by U.S. suppliers. Prior to disbursement by Eximbank, the supplier on a transaction must complete a supplier's certificate in which he certifies to Eximbank the amount of any discount, allowance, rebate, commission, fee or other payment made with respect to the goods to be financed other than regular commissions or fees paid by a supplier to its regular sales agent or representative in the ordinary course of business. If Eximbank has reason to believe that a false statement may be contained in the supplier's certificate, the matter is referred to the Department of Justice for investigation and possible prosecution. Under 28 U.S.C. 516, the Department has the exclusive authority to conduct all litigation in which the United States or any agency or officer thereof is a party or is interested.

False statements in the supplier's certificate are actionable under at least two statutes. Under 18 U.S.C. 1001 it is a crime for any person to knowingly and willfully make a false statement pertaining to any matter within the jurisdiction of any department or agency of the United States. The penalty for a violation of this section is a fine of not more than $10,000 or imprisonment for not more than five years or both. Any action under this section must be begun within five years of the offense being committed. Under 31 U.S.C. 3729 (the so-called "False Claims Act"), it is unlawful for a person to knowingly make or cause to be made a false claim for payment on the United States. Under this act the United States government may recover a civil penalty of $2,000, an amount equal to two times the amount of damages the government sustained and litigation costs. Any action under the False Claims Act must be brought within six years from the date the violation was committed.

Thus, depending on the facts of a particular case, it is not only legally possible, but may also be appropriate for Eximbank to recover the amount of damages it has sustained as a result of a false statement in a supplier's certificate. Matters involving allegations of bribery by Westinghouse Electric Corporation were investigated by a Federal grand jury, and charges were filed in 1978 against Westinghouse with respect to both Eximbank and AID financing. I am unable to provide you with details regarding those or any current criminal proceeding involving Westinghouse. You may wish to consult with the Department of Justice for more information.

SENATOR PROXMIRE: In a follow up to my last question I want you to know that I have had a member of my Banking Committee staff go to the Bank and review the Eximbank's files on the Philippine nuclear project. There were some documents he found such as exchanges of letters between William Casey, now head of the CIA, but then head of the Eximbank, and close advisers to President Marcos, and other correspondence between the Bank and Westinghouse. He wanted copies of these documents so he could discuss them with other Committee staffers and me. The Eximbank has insisted that these matierals, even though they do not contain proprietary information, cannot leave the custody of the Bank. Frankly, I would like the Bank to release such materials to my staff as they are pertinent to our oversight responsibilities. If confirmed will you work within the Bank to make sure that my staff can get copies of materials in the Bank's files that do not contain proprietary information?

MR. RYAN: Yes. Congressional committees are entitled to all information needed to carry out their oversight functions. Eximbank makes available without restriction all records kept in its files for personal inspection by members of Congress and their staffs in carrying out such functions. At the same time, we believe that consistent with the principles of the Freedom of Information Act such records should be made available in such a way as will enable certain kinds of information such as classified information, confidential business information and information disclosing the decision-making process of an agency to be safeguarded. For this reason, if copies of records are requested, they are edited to delete portions that may contain information of this kind. However, the complete records themselves continue to remain available for personal inspection at the Bank.

SENATOR PROXMIRE: I have seen a copy of the speech you gave to the Conference Board on February 20, 1985 about the deleterious effect the over-valued dollar was having on our ability to compete for sales both internationally and at home. I agree with your views and for years called upon the Reagan Administration to recognize the disastrous impact its budgetary deficits were having on our corporations and jobs for our workers -- and ultimately America's standard of living.

In your speech you endorsed an import surcharge on manufactured goods as one means of remedying the problem. What I want to know is how did your nomination get by Don Regan when you are advocating policies that were in the Gephardt/Bentsen trade bill?

MR. RYAN: Senator, I re-read that talk last evening and confirmed my recollection of it. I did not actually endorse an import surcharge but simply suggested that the Motorola proposal

at that date--February 1985--was a suitable focus for the debate on trade policy. I think you will find that I held the view that improvement in our trade picture required harmonizing of Free World economic policies, encouraging really free trade both in and out of the United States, and promoting foreign direct investment, especially in the LDC's. At the same time I felt that the Motorola proposal deserved to become the focus of a serious debate on the whole question.

In further answer to your question, however, I must tell you that I did not send Mr. Regan a copy of that talk to even allow your question to be raised.

DEAN A. GALLO
11TH DISTRICT, NEW JERSEY

PUBLIC WORKS AND TRANSPORTATION COMMITTEE
SUBCOMMITTEES
ECONOMIC DEVELOPMENT
WATER RESOURCES

SMALL BUSINESS COMMITTEE
SUBCOMMITTEE
SBA AND SBIC AUTHORITY, MINORITY ENTERPRISE AND GENERAL SMALL BUSINESS PROBLEMS

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June 9, 1986

Hon. Jake Garn
Chairman, Senate Banking Committee
534 Dirksen Building
Washington, D.C. 20510

Dear Senator Garn:

I am writing in strong support of the nomination of William Ryan as First Vice-President of the Export-Import Bank.

As a resident of Madison, New Jersey, Mr. Ryan is a constituent of mine and I am very proud to support his nomination, because I know that he has the background and experience needed to serve the United States with distinction in this crucial area of governmental policy development.

Mr. Ryan's experience in the private sector will serve him well as he takes on the broader responsibilities that go with this important assignment.

I am proud that our New Jersey communities have produced a significant number of professionals who are willing to apply their expertise to challenges in the public sector.

As a member of the House Small Business Committee and as a businessman myself, I am very supportive of efforts to increase the flow of American goods within international markets.

Again, I strongly support the nomination of Mr. Ryan and am confident that you will be as impressed with his qualifications as I am.

Best wishes,

Sincerely,

Dean Gallo

DEAN A. GALLO
Member of Congress